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Administration's Proposals to Refor...

ADMINISTRATION'S PROPOSALS TO REFORM THE FEDERAL GOVERNMENT'S PENSION BENEFIT GUARANTEE PROGRAM

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

OCTOBER 4, 1993

Serial 103–77

Printed for the use of the Committee on Ways and Means

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ADMINISTRATION'S PROPOSALS TO REFORM THE FEDERAL GOVERNMENT'S PENSION BENEFIT GUARANTEE PROGRAM

MONDAY, OCTOBER 4, 1993

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, D.C.

The subcommittee met, pursuant to call, at 2 p.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE
FRIDAY, SEPTEMBER 24, 1993

PRESS RELEASE #14
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1135 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A PUBLIC HEARING TO DISCUSS THE ADMINISTRATION'S PROPOSALS TO REFORM THE FEDERAL GOVERNMENT'S PENSION BENEFIT GUARANTEE PROGRAM

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will conduct a hearing to discuss the Administration's proposals to reform the Federally-insured pension benefit program and to improve the solvency of the Pension Benefit Guaranty Corporation (PBGC). The hearing is scheduled for Monday, October 4, 1993, beginning at 2:00 p.m., in the main Committee hearing room, 1100 Longworth House Office Building.

BACKGROUND

Since 1991, the Subcommittee on Oversight has conducted six hearings on the problems facing the defined-benefit pension system and PBGC. In testimony during these hearings, the Subcommittee received numerous reports indicating that the defined-benefit pension system faces growing financial difficulties stemming from the failure of some companies to properly fund their pension promises. Analyses conducted by the General Accounting Office (GAO), the Congressional Budget Office, and PBGC indicate that retirees and taxpayers are being put at risk by a relatively small number of very large, seriously-underfunded pension plans. These studies indicate that the underfunding of pension plans has worsened in recent years and, absent meaningful reforms, will continue to deteriorate. At the end of 1992, unfunded pension promises reached $51 billion, up by more than $10 billion over the previous year. This underfunding represents a significant potential claim against PBGC, which already has accrued a deficit of $2.7 billion.

On May 27, 1993, the Subcommittee issued a report to the full Committee on Ways and Means (WMCP: 103-15) making recommendations to: improve the financial solvency of PBGC and the defined-benefit pension system; reduce the increase in underfunding which occurs when underfunded pension plans grant new pension plan promises; require faster funding of existing unfunded pension plan promises; ensure that pension plan participants are fully informed of their pension plan's financial condition and PBGC's insurance coverage; require the GAO to conduct a review of the various reports required of pension plan sponsors; provide PBGC access to certain pension plan information; and change the current premium structure to improve PBGC's solvency and make the variable-rate premium more risk-related. In its report, the Subcommittee noted that, without legislative reform, there will be further deterioration of PBGC's financial solvency and the Federally-insured, defined-benefit pension system.

In announcing the hearing, Chairman Pickle stated: "At the Subcommittee's hearing in April 1993, the Administration announced its establishment of an interagency task force to examine the impact of pension plan underfunding on workers and retirees covered under the defined-benefit pension system and on the solvency of the Federal insurance program administered by PBGC.

This task force was charged with making recommendations on how best to address the problems caused by underfunded pension plans, in the context of promoting the goals of the Administration's overall pension policy. The task force recently completed its work. It is my expectation that the Administration's final recommendations will be ready and available for discussion at the Subcommittee's hearing."

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Persons submitting written comments for the printed record of the hearing should submit six (6) copies by the close of business, Friday, October 29, 1993, to Janice Mays, Chief Counsel and Staff Director, Committee on Ways and Means, U.S. House of Representatives, room 1102 Longworth House Office Building, Washington, D.C. 20515.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

*****

Chairman PICKLE. The chair would ask the subcommittee to come to order.

The chair has an opening statement and Mr. Houghton will also have an opening statement. We will then proceed to our witnesses.

The purpose of our hearing today is to review the administration's proposals to reform the federally insured pension benefit program and to improve the solvency of the Pension Benefit Guaranty Corporation, the PBGC.

The problems associated with chronically underfunded pension plans have been the subject of intense review by the Subcommittee on Oversight for the past 2 years at least. This will be our fifth hearing on the subject since 1992. During this period, we have received reports and recommendations from the prior administration, the Congressional Budget Office, the General Accounting Office, the Congressional Research Service, and a number of pension and benefit associations. Every single organization I know of that has examined this problem has concluded that pension underfunding is a serious problem and that, unless legislative reforms are enacted, this problem will become worse.

Most recently, after a comprehensive and lengthy review, this administration's interagency task force has reached the same conclusions. The administration officially endorsed these task force recommendations last Thursday. It is now clear beyond any doubt that legislative action must be taken. Any further delay only makes the problems worse, and the fixes so to speak, more difficult in time to come.

On June 4, 1993, the members of this subcommittee made general recommendations to the Committee on Ways and Means on the steps that should be taken to reform this system. In summary, the subcommittee made recommendations to: Improve the financial solvency of PBGC and the defined-benefit pension system; reduce the increase in underfunding which occurs when underfunded pension plans grant new pension plan promises; require faster funding of existing unfunded pension plan promises; ensure that pension plan participants are fully informed of their pension plan's financial condition, and PBGC's insurance coverage; require the General Accounting Office to conduct a review of the various reports required of pension plan sponsors; provide PBGC access to certain pension plan information; and change the current premium structure to improve the PBGC's solvency and make the variable rate premium for risk related.

In our report, the subcommittee noted that without legislative reform, there will be further deterioration of PBGC's financial solvency and the federally insured defined-benefit pension system. The administration proposals, which we will review today, appear to be largely consistent with the intent of the subcommittee's recommendations and we are glad to have them.

Therefore, I look forward to working with the administration in advancing a meaningful package of pension reforms as soon as possible. Also, I want to applaud PBGC's director, Martin Slate, for his diligence and note that the administration put forward specific recommendations by September 30, as promised previously. Now the legislative process can continue to move forward.

Finally, I would note that the root of all of our pension problems is that, for decades, labor and management have negotiated increased pension benefits without funding those promises. Instead, unions and management by and large have been content to rely on Federal guarantees. For its part, the Federal Government has permitted, we have permitted, the underfunding of pension plans and has charged a woefully inadequate insurance premiums for guaranteeing them. And as a result, pension plans are now underfunded by $51 billion.

The PBGC has already incurred significant losses that have left it with a $2.7 billion deficit. Retirees and taxpayers are at risk and the risks are increasing. Without legislative reform, these risks and losses will only get worse.

The time to act is now.

The chair yields to Mr. Houghton for an opening statement.

Mr. HOUGHTON. Thank you very much, Mr. Chairman. Mr. Slate, thanks very much for being with us this afternoon. I am honored to join in your opening remarks and also I am clear on the strength in the pension system in the United States.

At our hearing in April, the administration witnesses acknowledged the need to take a long, hard look at the pension system and at the long-term liability of PBGC. After 6 months of intense review by the administration's task force, that has been done. You have a plan to improve the solvency of the whole system.

There are only a few variables that come into play. The main variables are the pension funding rules, the premium structure and the enforcement tools available to the U.S. Government. The administration package contains, I believe, a creative combination of reforms in each of these areas by forcing underfunded plans to accelerate their timetable and by making them pay an insurance premium to the PBGC which more accurately reflects the risk that the plan poses. It strengthens the enforcement tools of the PBGC by allowing it to seek judicial remedies before a plan fails.

Whether the administration's proposal is the best approach or not, that is the whole point of this hearing. We will be about it and we will listen to you intently.

Finally, Mr. Chairman, I believe we should review the administration's proposal with an open mind. I think that you want to do that, but we should realize that the pension changes are not occurring in a vacuum.

Pension sponsors were hurt by tax increases and pension sponsors will be hit by upcoming changes in the health care reform campaign. Therefore, we should take an eye on the cumulative effect of these major changes on American business and its ability to increase employment. So I am anxious to learn the details.

I intend to work with you Mr. Chairman, and thank you very much.

Chairman PICKLE. Mr. Kleczka, would you like to make an opening statement.

Mr. KLECZKA. The only statement that I have, at this point, is not only to agree with you, but also with the Ranking Minority of the committee. It is a proposal whose time has come. Hopefully it will provide increased solvency for the Pension Benefit Guaranty Corporation.

And Mr. Chairman, for the record, I would ask you that a very short statement be put in the record on my behalf.

Chairman PICKLE. It will be put in the record.

[The prepared statement follows:]

OPENING STATEMENT for
GERALD D. KLECZKA
Subcommittee on Oversight Hearing on the
Administration's Proposal to Reform the PBGC
October 4, 1993

...Thank you Mr. Chairman. As a new member of this Subcommittee, I am pleased to be associated with you, and your work on this panel to protect the best interests of the public.

...Your foresight in calling for a review of the PBGC sets an excellent example for all responsible legislators, and is in large part, the reason why we are here today listening to the Mr. Slate and Mr. Hardock.

...Let me first say that workers and pensioners in the U.S. do not need to panic because of our increased scrutiny of PBGC. We are atttempting to protect them.

...Similarly, companies and sponsors of defined benefit plans should not panic. We do not want to over burden them. We want to help them meet their obligations to their employees.

...We are also hear to protect the American taxpayers.

...There are important parallels between the our recent experience with savings and loans and the PBGC's guarantees to private pension plans, and I want to make sure we do not have to go to the American taxpayers and ask for their help.

...Although the current cash flow of the PBGC is in good shape, the growing liabilities due to underfunding of plans is still a debt that will come due.

...Predictions of future insolvency are not wild speculation. It is certain that increased demands on the PBGC will occur as workers with defined benefit plans enter retirement.

...Congress must act now to prevent this situation from becoming unmanageable.

...I am pleased to listen to the Administration's proposals. From what I can tell they have worked hard and dealt with the difficult issues involved in this matter, and I congratulate them.

...I look forward to working with your Mr. Slate and you Mr. Hardock, and pleased you are hear before us.

...Thank you Mr. Chairman.

Chairman PICKLE. Our first witness will be Mr. Martin Slate, the Executive Director of the Pension Benefit Guaranty Corporation. He is accompanied at the table by Mr. Randolph Hardock and he represents the Department of the Treasury, specifically the Office of Tax Policy.

We will proceed to receive the statement from Mr. Slate. And then, if you have a statement Mr. Hardock you may add that to it.

We are glad to have you, Mr. Hardock and Mr. Slate. This has been a kind of long time coming. We are glad that you are here and we are anxious to hear what you have to say.

STATEMENT OF MARTIN SLATE, EXECUTIVE DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION, ACCOMPANIED BY JUDY SCHUB, ASSISTANT EXECUTIVE DIRECTOR FOR LEGISLATIVE AFFAIRS; AND RANDOLPH H. HARDOCK, BENEFITS TAX COUNSEL OFFICE OF TAX POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. SLATE. Thank you, Mr. Chairman. Let me introduce my colleague, Judy Schub, our Assistant Executive Director for Legislative Affairs at the PBGC. We have submitted a lengthy statement for the record and I will summarize that statement here now.

Chairman PICKLE. Mr. Slate, that is satisfactory, but if you are going to summarize when you make your testimony, if you could refer to the pages where the documents are so that we could follow you as close as we can.

Mr. SLATE. I believe you have a copy of my oral testimony. Mr. Chairman and members of the subcommittee: I am pleased to be here before you today to discuss the administration's Retirement Protection Act. This reform legislation is the product of months of intensive work on the part of a task force established last March by Secretary of Labor Robert Reich to examine the concerns that have been raised by pension protection and the Pension Benefit Guaranty Corporation.

The administration's reform proposal is comprehensive and balanced. As the Secretary has stated, if the reforms are enacted, they will assure that the hard-earned pensions of American workers and retirees are safe and secure.

Our reforms may be summed up in one word: Funding. We believe that the present pace and certainty of pension plan funding are inadequate and that steps should be taken to assure that sponsors of underfunded plans significantly accelerate their pension contributions.

These proposals will enhance the health of the defined benefit system by increasing funding in underfunded plans. The key is to increase funding so that benefit security for workers and retirees is assured.

Our major reforms will: strengthen the funding rules for underfunded plans; enhance PBGC compliance authority; broaden participant disclosure requirements; and increase premiums for those plans that pose the greatest risk.

Fully funded plans will not be affected by our major reforms. For underfunded plans, the proposals will assure marked, steady increases in the funding of benefits. At the same time, we have fash-

ioned reasonable requirements so that companies will continue to operate, to provide jobs, and to contribute to the American economy.

Secretary Reich has asked me to underline his appreciation to this subcommittee for the leadership it has brought to these issues and for the assistance you have provided us in developing these proposals.

Chairman PICKLE. Mr. Slate, can you tell the Secretary that we appreciate his statement. We hope you also relay to him that we offer full cooperation and we are glad he made these recommendations and has given his leadership. We appreciate that.

Mr. SLATE. I am sure he will be glad to hear that, Mr. Chairman.

As a whole, the defined benefit pension system insured by the PBGC is strong and well-funded. The vast majority of plans, more than 75 percent nationwide, are fully funded. Underfunding is concentrated in a few industries such as steel, automobile, tire and airlines.

Pension underfunding, however, is growing and persistent. Total underfunding has gone from $27 billion in 1987 to $38 billion in 1991. It is expected to climb to over $45 billion when the 1992 figure is reported. While much of the most recent underfunding is attributable to a drop in interest rates, it is clear that the current funding rules are not working.

The fact that a plan is underfunded does not mean a participant's benefits are jeopardized or that the risk to the PBGC heightened. Too often, though, underfunding occurs in plans of troubled companies.

PBGC reported that for 1991, $12 billion in underfunding is in plans sponsored by companies in difficult financial circumstances. Given the current funding rules and the continued difficulties in heavy industry, underfunding in these plans is likely to increase in the coming years. For participants, this underfunding threatens the loss of benefits not covered by the PBGC guarantee.

These underfunded plans also pose a long-term threat to the PBGC. In recent years, large claims to the PBGC have outstripped premium revenue. PBGC's balance sheet for the single-employer program for 1992 showed a deficit of $2.7 billion. Even though the deficit is not expected to go up for 1993, and may even decline, the long-term problem will remain. This ultimately could threaten the ability of the PBGC to safeguard pension benefits.

The PBGC is not in any immediate danger. The agency's annual revenues exceed the benefits it must pay to retirees. PBGC's payments are spread out over many years so it can continue to pay benefits for a long time. There are serious problems, however, that must be addressed while they are still manageable.

Our primary reform is to strengthen the funding requirements for underfunded plans.

In 1974, ERISA established the concept that a plan must put aside money currently for benefit payments that are due in the future. The ERISA funding rules provided a good start for sound funding, but many plans remain severely underfunded. In part, acute underfunding persists because companies may fund a portion of their benefit liabilities over a period of 30 to 40 years.

Congress addressed these problems in the Omnibus Budget Reconciliation Act of 1987. OBRA 1987 introduced the deficit reduction contribution, or DRC. This is a minimum contribution requirement intended to accelerate funding in underfunded plans. Among other things the DRC shortens the payment period for underfunded plans.

Despite the DRC, plan funding has not improved since 1987. Fully within the law, many employers have been able to make little or no pension contributions, even though their plans are severely underfunded. Over the 3-year period, 1989 through 1991, for example, after paying, for current year accruals, contributions to 40 percent of the plans of companies with the largest underfunding did not even cover the interest on the plan's unfunded liabilities. This is comparable to paying off only part of the interest on a credit card and nothing on the principal.

Our reforms would strengthen the DRC to accomplish what was intended in 1987. Employers with underfunded plans no longer will lawfully be able to avoid making contributions to reduce their liabilities.

We propose three reforms that will accelerate funding and bring certainty that appropriate contributions are made to underfunded plans.

First; we speed up the basic contribution formula. Under our reforms, most new liabilities in severely underfunded plans will be funded within 5 years.

Second, our proposals eliminate the "double counting" that occurs when certain credits and gains are applied to the determination of liabilities and contributions. This double counting of these gains can reduce or eliminate any contribution amount due.

Finally, employers have been able to minimize the amount of underfunding to which contribution requirements apply through the selective choice of actuarial assumptions such as interest rates and mortality tables.

Our legislation would require employers with underfunded plans to use specified interest rate and mortality assumptions to determine their contributions. Further, in instances of large underfunding, IRS approval would be required for a change in the other assumptions used to determine contribution amounts.

In addition to these three overall changes in the funding rules, the legislation includes a special solvency rule to insure that severely underfunded plans are able to meet their benefit obligations. An employer is required to maintain plan assets equivalent to 3 years of benefit payments.

The bill requires that benefit increases be funded over an accelerated funding schedule—in most cases from 5 to 7 years. It also requires that employers recognize immediately any benefit increases that have been bargained but are not yet in effect.

It is our view that benefit increases should be paid for speedily through strengthened funding requirements. Explicit restrictions on benefit increases are not necessary and are unfair to working people and to retirees.

Our proposals will be effective for plan years beginning in 1995. These new rules will pick up increases that were negotiated or will be negotiated in 1993 and 1994.

Accelerated funding is essential if plans are to be placed on a sound footing. We do, however, want companies to move forward with their business. Thus, the legislation contains a special transition rule to protect employers from extraordinary increases in their annual contributions for up to 7 years.

When it is all said and done, these rules should markedly increase funding in the most underfunded plans.

As the chart shows, based on an initial analysis, funding should improve, over a 15-year period, from the current average of 55 percent to 90 percent of all benefits and to 100 percent of vested benefits.

Note that these increases bring much more than current law would bring. The blue line is current law, the green line is the reform proposal.

Strengthened funding rules should assure improvements in most cases. There are, however, special circumstances where enhanced PBGC compliance authority is also needed to provide better pension protection.

OBRA 1987 gave the agency and participants more recourse against the assets of the plan sponsor, including all members of the sponsor's corporate controlled group. OBRA 1987 made the entire corporate group joint and severally liable for minimum funding.

These rules left a major gap in protection. Numerous corporate transactions such as the breakup of the controlled group, can substantially diminish the assets available to maintain a plan. In these circumstances, PBGC's only remedy is plan termination. Termination is a harsh remedy because participants are hurt, and the increased employer liability can force employers out of business.

Our proposals authorize the PBGC to apply to Federal court for remedies other than involuntary plan termination if we determine that certain corporate transactions would create a risk of longrun loss to the agency.

For example, the PBGC could seek to have a firm leaving a corporate group retain responsibility for contributing to the group's underfunded plan for a certain period of time.

As part of this proposal, we would require that corporate groups with more than $50 million of underfunding provide PBGC with 30 days advance notice of designated significant corporate transactions that might affect underfunding. In addition, our reforms would add an array of additional tools such as enhanced reporting requirements for underfunded plans that would enable PBGC to better monitor and protect funding.

We also continue to support bankruptcy reforms that would, one, make it clear that companies are required to continue to make their minimum funding contributions while in bankruptcy; and two, give the PBGC the option of being a member of bankruptcy creditors' committees.

Our reforms would require that timely, clear information on plan funding and PBGC guarantees be provided to participants in underfunded plans. Workers and retirees often do not understand the financial condition of their pension plans or the consequences of underfunding of their promised benefits.

Our proposal requires administrators of underfunded plans to notify plan participants and beneficiaries about the plan's funding

status and the PBGC's guarantee. The bill requires that the notice be written so that it may be understood by the average plan participant.

The administration's proposal phases out the cap on the variable rate premium over a 3-year period ending in 1997. The elimination of the premium cap is designed to provide a further incentive for funding, as well as to help close the PBGC deficit.

PBGC's annual insurance premium for single-employer defined benefit pension plans has two elements—a flat rate charge of $19 per participant paid by all single-employer plans, and a variable-rate charge of $9 per $1,000 of unfunded vested benefits, which is paid only by underfunded plans. The variable-rate charge has a maximum limit of $53 per participant. This limit weakens the funding incentive for the most seriously underfunded plans.

These plans also pay no additional premiums for any additional underfunding. Plans at the cap account for 80 percent of all the underfunding in single-employer plans, but their premium payments represent only about 25 percent of the PBGC's total premium revenues.

These are the highlights of the administration's reforms, strengthened funding rules, enhanced PBGC compliance authority, broadened disclosure to workers and retirees, and increased premiums for plans posing the greatest risk.

The administration believes that these reforms represent a firm, yet balanced approach to underfunding and to assuring benefit security. They will markedly increase funding in the most underfunded plans and they will do so in a reasonable and affordable way. These reforms will stabilize the financial condition of the PBGC for the long run. Based on past PBGC experience, we expect that the PBGC deficit will be eliminated within 10 years.

Our proposals do nothing to diminish PBGC guarantees. Reducing worker protection is unacceptable.

The administration places high priority on retirement security. We have worked hard over the past few months to develop a meaningful, balanced package that addresses the concerns expressed by this subcommittee and others.

As the legislative process moves forward, the administration stands ready to work with the committees of jurisdiction and with others that have a stake in the pension system. We have been the beneficiaries of much good advice, and we want the dialog to continue.

Thank you. I would be happy to answer your questions.

[The prepared statement and attachment follow:]

Testimony of Martin Slate
Executive Director
Pension Benefit Guaranty Corporation

Before the
Oversight Subcommittee
Committee on Ways and Means
United States House of Representatives

October 4, 1993

I. INTRODUCTION

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before you today to discuss the Administration's Retirement Protection Act. This reform legislation is the product of months of intensive work on the part of a Task Force established last March by Secretary of Labor Robert Reich to examine the concerns that have been raised about pension protection and the Pension Benefit Guaranty Corporation (PBGC).

The Administration's reform proposal is comprehensive and balanced. If enacted, it will assure that the hard-earned pensions of American workers and retirees are secure.

Our reforms may be summed up in one word: funding. We believe that the present pace and certainty of pension plan funding are inadequate and that steps should be taken to assure that sponsors of underfunded plans significantly accelerate their pension contributions.

These proposals will enhance the health of the defined benefit system by increasing funding in underfunded plans. The key is to increase funding so that benefit security for workers and retirees is assured.

Our major reform measures will:

- strengthen the funding rules for underfunded plans;
- enhance PBGC compliance authority;
- broaden participant disclosure requirements; and
- increase premiums for those plans that pose the greatest risk.

Fully funded plans will not be affected by our major reforms.

Secretary Reich has asked me to underline his appreciation to this subcommittee for the leadership it has brought to these issues and for the assistance you have provided us in developing our proposals.

II. HISTORY

The Task Force included representatives of the National Economic Council, the Office of Management and Budget, and the Departments of Treasury, Commerce, and Labor, as well as the PBGC. The group began its work by consulting with representatives of the Congressional committees of jurisdiction. We then moved on to discussions with representatives of the General Accounting Office and the Congressional Budget Office, and with a broad range of groups, including major labor and business leaders. All told, 77 people appeared before the Task Force.

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These discussions were informative in two respects. First, it quickly became apparent that concern about the health of the PBGC and the defined benefit system is widespread. Virtually everyone stated that legislative reform is needed. Second, there is a divergence of views as to how the system should be made more effective. Our challenge was to fully consider the different perspectives of all who have a stake in the retirement plan system and then to forge an effective, balanced solution.

Our reforms meet this challenge. For underfunded plans, the proposals will assure marked, steady increases in the funding of benefits. At the same time, we sought to fashion reasonable requirements so that companies will continue to operate, provide jobs, and contribute to the American economy.

III. FINDINGS

As a whole, the defined benefit pension system insured by the PBGC is strong and well-funded. The vast majority of plans - more than 75% nationwide - are fully funded. Underfunding is concentrated in a few industries, such as steel, automobile, tire and airlines.

This pension underfunding, however, is growing and persistent. Total underfunding has gone from $27 billion in 1987 to $38 billion in 1991 and is expected to climb to over $45 billion when the 1992 figure is reported. While much of the most recent underfunding is attributable to the drop in interest rates, it is clear that the current funding rules are not working adequately.

The fact that a plan is underfunded does not necessarily mean that a participant's benefits are jeopardized or that the risk to the PBGC is heightened. Too often, though, underfunding occurs in plans of troubled companies. PBGC reported that, for 1991, $12 billion of underfunding is in plans sponsored by companies in difficult financial circumstances. Given the current funding rules and the continued difficulties in heavy industry, underfunding in these plans is likely to increase in the coming years. For participants, this underfunding threatens the loss of benefits not covered by the PBGC guarantee.

These underfunded plans also pose a long-term threat to the PBGC. In recent years, large claims to the PBGC have outstripped premium revenue. As a result, PBGC's balance sheet for 1992 showed a deficit of $2.7 billion: assets of $6.3 billion, and liabilities of $9 billion. Even though the deficit is not expected to go up for 1993, and may even decline, the long-term problem will remain. This ultimately could threaten the ability of the PBGC to safeguard pension benefits.

The PBGC is not in any immediate danger. The agency's revenues exceed the benefits it must pay to retirees. PBGC's payments are spread out over many years, so it can continue to pay benefits for a long time. There are serious problems, however, that must be addressed. We should deal with these problems now, while they are still manageable, and before more extreme measures represent the only available course of action.

IV. THE LEGISLATION

STRENGTHEN THE FUNDING RULES FOR UNDERFUNDED PLANS

Our primary reform is to strengthen the funding requirements for underfunded plans.

<u>ERISA Rules</u>

In 1974, ERISA established the concept that a plan must put money aside currently for benefit payments that are due in the future. One of the mechanisms introduced by ERISA to ensure that plans are properly funded is the funding standard account. A plan's minimum funding requirement for a year is based on the balance in its funding standard account. Enough must be contributed each year to eliminate any shortfall in the account.

The ERISA funding rules provided a good start for sound funding, but many plans remain severely underfunded. In part, acute underfunding persists because companies may fund a portion of their benefit liabilities over a period of 30 to 40 years.

OBRA '87

Congress addressed these problems in the Omnibus Budget Reconciliation Act of 1987. OBRA '87 introduced the deficit reduction contribution (DRC), an additional minimum contribution requirement intended to accelerate funding in underfunded plans.

The DRC breaks a plan's liabilities into two components. The "old" liability, attributable to pre-1988 benefits, is amortized over 18 years. The "new" liability, attributable to years after 1987, must be funded at a rate of 30% per year for plans that are not more than 35% funded, i.e., that have a "funding ratio" of 35% or less. Generally this results in an amortization period of about five years. This 30% rate decreases as the plan's funding level increases - to a minimum of 13.75% (approximately a 12-year amortization period) for better funded plans.

Despite the DRC, plan funding has not improved since 1987. Fully within the law, many employers have been able to make little or no pension contributions, even though their plans are severely underfunded. Between 1989 and 1991, for example, contributions (after paying for current year accruals) to 40% of the plans of companies with the largest underfunding did not even cover the interest on their unfunded liabilities. This is comparable to paying off only part of the interest on a home mortgage and none of the principal.

Reform Proposals

Our reforms would strengthen the DRC to accomplish what was intended in 1987. Employers with underfunded plans no longer will lawfully be able to avoid making contributions to reduce their unfunded liabilities.

We propose three reforms that will accelerate funding and bring certainty that appropriate contributions are made to underfunded plans.

(1) Strengthen the DRC Formula

To speed up funding, we strengthen the basic DRC formula. The current formula does not require funding at a level sufficient to cover participants' nonforfeitable benefits.

Our proposals would have plans with funding ratios of up to 60% - rather than the current 35% - fund at a rate of 30% per year. The 30% rate will decline gradually to 20% as a plan moves toward full funding. In severely underfunded plans, most new liabilities will be funded within five years. These contributions will minimize participant and PBGC exposure.

(2) End Double Counting

A second problem is that the DRC has not functioned as a true minimum contribution requirement because of the way in which a plan's DRC interacts with its funding standard account. Under current law, the DRC is added to the funding standard account. Certain credits, however, are counted twice: in the calculation of both the DRC and the funding standard account. Thus, gains in plan assets reduce the amount of a plan's underfunding under the DRC calculation. These same gains also, in effect, reduce the DRC again when the DRC becomes a charge to the funding standard account. The resulting "double counting" of these gains can reduce or eliminate any amount due under the DRC.

Our proposal eliminates this double counting so that the DRC will operate as a "stand-alone" rule. In other words, a plan sponsor will be required to pay the larger of the DRC or the regular minimum funding requirement.

(3) Constrain Assumptions

Finally, employers have been able to minimize the amount of underfunding to which the DRC applies through the selective choice of actuarial assumptions such as interest rates and mortality tables. For example, current liability for DRC purposes must be calculated using an interest rate assumption that falls within a corridor of 90 to 110 percent of a four-year weighted average of the 30-year Treasury rate. An employer that wishes to minimize DRC contributions will assume the 110 percent interest rate because use of this higher interest rate will lower its estimate of current liability.

Similarly, an employer may choose to use a mortality table that predicts death at a relatively early age among plan participants. This has the effect of decreasing liabilities and contributions because it reduces the estimate of the amount of benefits to be paid to participants.

Our legislation narrows the corridor interest rate assumptions to between 90% to 100%. It also requires use of the GAM 83 mortality table, which is the mortality table used in a majority of the states to calculate insurance company reserves for annuities. To mitigate the potentially harsh impact of this change, the increase in liability attributable to years before 1995 that results from the application of this constraint in assumptions may be amortized over 12 years.

Further, in instances of large underfunding, IRS approval would be required for a change in the other assumptions used to calculate the DRC. This pre-approval would be required only if an employer's plan (plus other plans of the employer or the employer's controlled group) were underfunded by more than $50 million and only if the change in assumptions would decrease unfunded current liability by either: 1) more than $5 million and 5% of the plan's current liability before the change; or 2) $50 million or more.

Plan Solvency

In addition to these overall changes in the funding rules, the legislation includes a special solvency rule to insure that severely underfunded plans are able to meet their benefit obligations. The solvency rule applies when a plan's liquid assets have been depleted to the extent that its ability to satisfy its current benefit obligations is endangered. An employer sponsoring such a plan is required to maintain in the plan cash and marketable securities equal to approximately three years' worth of benefit payments and other disbursements. Plans will not be permitted to pay lump sums or purchase annuities for their participants while a scheduled solvency payment is outstanding.

Benefit Increases

The bill requires that benefit increases be funded over an accelerated funding schedule - in most cases, over five to seven years. It also requires that employers recognize immediately, for funding purposes, any benefit increases that have been bargained but are not yet in effect. (Under current law, an employer is not required to fund these benefit increases until they are effective.)

It is our view that benefit increases should be paid for speedily through strengthened funding requirements. Explicit restrictions on benefit increases are not necessary and are unfair to working people and to retirees.

Effective Dates

Our proposals will be effective for plan years beginning in 1995. These new rules will pick up increases that were negotiated in 1993 and 1994.

Transition Rule

Accelerated funding is essential if plans are to be placed on a sound footing. We do, however, want companies to move forward with their business. Thus, the legislation contains a special transition rule to protect employers from extraordinary increases in their annual contributions for up to seven years. Although the rule varies according to the plan's funding ratio, it generally limits the required annual increase in employer contributions to the amount necessary to achieve a three percentage point per year increase in the plan's funding ratio. (Thus, under this rule, a plan with a 50% funding ratio as of the end of 1994 would need to increase this ratio to 53% in 1995 and 56% in 1996.)

Remove Impediments to Funding

Most of our funding reforms strengthen the minimum funding requirements. We also seek to remove certain disincentives for some plan sponsors to contribute more than is required under the minimum funding rules.

- We provide excise tax relief for employers that maintain both a defined contribution and defined benefit plan so that they may contribute more to their defined benefit plans.
- We provide excise tax relief for contributions made by employers to fully fund their benefit liabilities when they terminate their small plans.

ENHANCE PBGC COMPLIANCE AUTHORITY

Strengthened funding rules should assure improvements in most cases. There are, however, special circumstances where enhanced PBGC compliance authority is needed to provide better pension protection.

(1) Intermediate Remedies to Keep Controlled Group Assets Available

OBRA '87 introduced several measures designed to give PBGC and participants recourse against the assets of the plan sponsor, including all members of the sponsor's controlled group. OBRA '87 made the entire controlled group joint and severally liable for minimum funding. Further, PBGC received a lien for missed funding contributions, and the agency's liability claim was increased.

The OBRA '87 rules left a major gap in protection. Numerous corporate transactions, such as the break-up of the controlled group, the liquidation of the contributing sponsor, or the spinoff of a division and its plan to a weak buyer, can substantially diminish the assets available to maintain a plan. These transactions can increase the risk of plan termination, with the potential for harm both to participants and the PBGC.

The PBGC's early warning program seeks to identify these transactions before they occur. Even when the PBGC learns of the transaction, we frequently can do very little because our only remedy is to terminate the plan.

Termination is a harsh remedy because participants stop earning benefits, and the increased employer liability arising on termination can force employers out of business. The PBGC's ability to negotiate is impaired, particularly in large cases, because termination is not always a credible threat.

Our proposals authorize PBGC to apply to the court for remedies other than involuntary plan termination if we determine that certain corporate transactions, if implemented, would create a risk of long-run loss to the agency (the same statutory standard that applies to involuntary terminations).

For example, the PBGC could seek to have an employer leaving a controlled group retain responsibility for contributing to the group's underfunded plan for a certain period of time.

As part of this proposal, we would require that controlled groups with more than $50 million of underfunding provide PBGC with thirty days advance notice of designated significant corporate transactions that might affect underfunding.

(2) Additional PBGC Tools

In addition, our reforms would:

- require other employers to inform PBGC of significant corporate events after they occur;
- require employers with large underfunded plans to provide the PBGC with annual reports containing specified actuarial and financial information;
- provide ongoing plans a claim for pension underfunding against liquidating sponsors or controlled group members;
- prohibit employers from increasing benefits in underfunded plans during a bankruptcy proceeding;
- authorize the PBGC to enforce minimum funding requirements when missed contributions exceed $1 million; and
- authorize the PBGC to immediately file a lien against an employer's assets on behalf of a plan, and for the full amount of the missed contribution, if the employer fails to make a contribution of more than $1 million.

With these tools, we are confident that the PBGC will be able to step in and make a difference in those important situations where the funding rules do not provide sufficient benefit protection.

(3) Bankruptcy

We continue to support bankruptcy reforms that would: 1) make it clear that companies are required to continue to make their minimum funding contributions while in bankruptcy; and 2) give the PBGC the option of being a member of creditors' committees.

BROADEN PARTICIPANT DISCLOSURE REQUIREMENTS

(1) Disclosure

Our reforms would require that timely, clear information on plan funding and PBGC guarantees be provided to participants in underfunded plans.

Although plans must provide participants with considerable material on the financial status of their plans, workers and retirees often do not understand the financial condition of their pension plans or the consequences of underfunding of their promised benefits. They also may not know that PBGC's guarantees have limits and that some of their benefits may not be fully covered. They receive different information at different times, often in ways that are difficult to understand.

Our proposal requires plan administrators of underfunded plans to notify plan participants and beneficiaries about the plan's funding status and the limits on the PBGC's guarantee should the plan terminate while underfunded. The bill requires that the notice be written so that it may be understood by the average plan participant. PBGC will provide a model notice and other guidance shortly after enactment.

(2) Missing Participants

Our bill seeks to facilitate payment of benefits to so-called "missing participants." Employers terminating fully funded plans cannot always locate every participant but are required to account for missing participants in order to complete the termination. Employers attempt to resolve this problem through several methods, such as setting up bank accounts or purchasing deferred annuity contracts for the missing people. These methods have often proved inadequate because missing participants may later come forward and be unable to locate their benefits. If no funds are received from the plan, the PBGC may be liable for the guaranteed benefit of a missing participant.

The legislation addresses this problem by establishing the PBGC as a clearinghouse for the payment of these benefits. Thus, as an alternative to purchasing annuity contracts, employers may transfer assets for the benefits to the PBGC, and the PBGC will pay benefits to the participants when they are finally located.

INCREASE PREMIUMS FOR THOSE PLANS THAT POSE THE GREATEST RISK

The Administration's proposal phases out the cap on the variable rate premium over a three-year period. The elimination of the premium cap is designed to provide a further incentive for funding, as well as to help close the PBGC deficit.

PBGC's annual insurance premium for single-employer defined benefit pension plans has two elements - a flat-rate charge of $19 per participant paid by all single-employer plans, and a variable-rate charge of $9 per $1,000 of unfunded vested benefits, which is paid only by underfunded plans. The variable-rate charge gives companies with underfunded plans a greater financial incentive to properly fund their plans. However, the variable-rate charge has a maximum limit of $53 per participant. This limit weakens the funding incentive for the most seriously underfunded plans. Companies with the largest amount of underfunding pay effectively only $3-4 per $1,000 of underfunding because of the cap. Further, these plans pay no additional premiums for any additional underfunding. Plans at the cap account for 80% of all the underfunding in single-employer plans, but their premium payments represent only about 25% of PBGC's total premium revenues.

Under the reform proposal, the premium ceiling would be phased out over the next three years. In general, the cap would be removed by 1997.

MISCELLANEOUS REFORMS

We propose a number of other changes. These include:

- elimination of the quarterly contribution requirement for well-funded plans;
- more flexible remedies for the PBGC to address noncompliance in standard termination procedures;
- revision of the interest rate and mortality assumptions that a plan may use to calculate a lump-sum distribution;
- the rounding down of the annual increases in the contribution and benefit limitations for retirement plans; and
- elimination of so-called "age-weighted" profit-sharing plans.

V. CONCLUSION

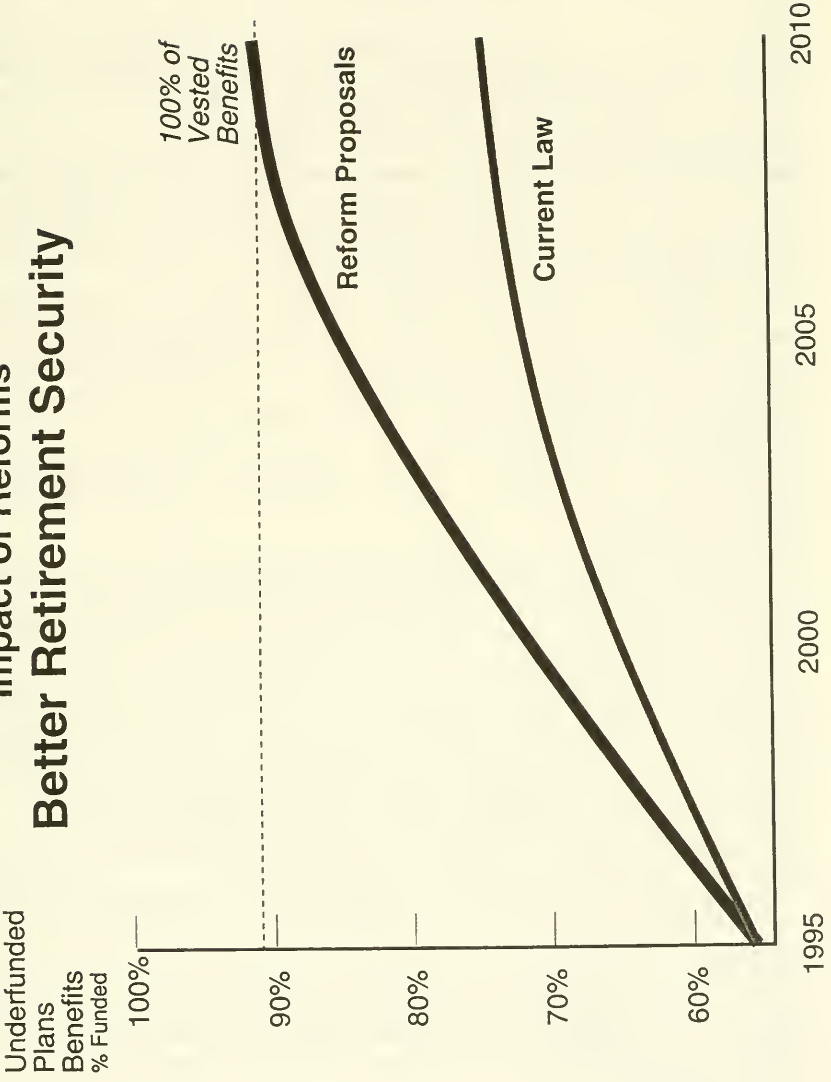
The Administration believes that these reforms represent a firm, yet balanced approach to underfunding and to assuring benefit security. They will markedly increase funding in the most underfunded plans, and they will do so in a reasonable and affordable way. Based on an initial analysis, funding should improve, over a 15-year period, from the current average of 55% of all benefits to 90%, and from an average of 60% of vested benefits to 100%. (See attached chart.) These reforms will stabilize the financial condition of the PBGC for the long run. Based on past PBGC experience, we expect that the PBGC deficit will be eliminated within ten years.

Our proposals do nothing to diminish PBGC guarantees. *Reducing worker protection is unacceptable.*

The Administration places a high priority on retirement security. We worked hard over the past few months to develop a meaningful, balanced package that addresses the concerns expressed by this subcommittee and others.

As the legislative process moves forward, the Administration stands ready to work with the Committees of jurisdiction and with others that have a stake in the pension system. We have been the beneficiaries of much good advice, and we want the dialogue to continue.

Thank you. I would be happy to answer your questions.


Impact of Reforms
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% Funded
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1995
2000
2005
2010
100% of Vested Benefits
Reform Proposals
Current Law

Chairman PICKLE. Mr. Hardock, do you have a statement to make.

Mr. HARDOCK. I don't have a prepared statement but wanted to say that Secretary Bentsen has a longstanding interest in the PBGC and that Treasury was an active participant in the task force and strongly supports these recommendations.

There are three major points. The first is that the proposal is targeted at the plans that caused the PBGC public; the underfunded plans. Second is that the proposal is fair. It gradually improves the funding of plans and that strikes a balance between the need to get the underfunding problem dealt with and the need to avoid sudden increases in costs for employers.

And third, and perhaps equally or most important, the proposal does not increase the Federal budget deficit. The major offset is the repeal of the risk-related premium cap. The proposal does not increase flat rate premiums to the PBGC.

Thank you. I will answer any other questions that you have.

Chairman PICKLE. Thank you.

Mr. Slate, I am going to assume for clarity purposes that the measure you are advancing today is officially the administration's recommendations.

Mr. SLATE. Yes.

Chairman PICKLE. Not just the task force that you represent. And Mr. Hardock, I am assuming that the Treasury supports these recommendations as part of the administration's official proposals.

Mr. HARDOCK. Yes, sir.

Chairman PICKLE. That is good. We have a lot of questions, and we will go through them as quickly as we can. First, I don't think I need to repeat that your task force was formed and you did find that the level of pension plan underfunding was at a level of over $50 billion. You have a deficit of $2.7 billion; is that correct?

Mr. SLATE. The $2.7 billion is the PBGC deficit. Yes, sir.

Chairman PICKLE. Now, will this deficit of $2.7 billion continue to increase if legislative reform is not enacted?

Mr. SLATE. Yes. Given the way that the law is set up, and given the natural ebbs and flows of industrial life, my sense is that it will increase.

Chairman PICKLE. Let me ask you a broader question. Are the risks to our current defined benefit system increasing? That is, are companies shifting from the defined benefits system to defined contribution plans? Is that happening in general now throughout the pension program?

Mr. SLATE. Let me answer that in two parts—I believe it is not so much a question of shifting to defined contributions plans, as that there haven't been as many startups of defined benefit plans. But, the overall issue of pension shift trends and so forth is one that this administration is quite concerned about.

Our thought is that strengthening the PBGC and shoring up the PBGC system would be an excellent first step in addressing retirement security and that it would free us up to look at some of the other concerns.

Chairman PICKLE. I am concerned that as we strengthen and tighten up on the enforcement mechanism, we don't weaken the

system and encourage the creation of further contribution plans. Some companies have both.

I want to be sure that they can't shift from one to the other and leave one destitute in favor of a new approach. I want to be certain that that is not allowed and that is not your intent.

Mr. SLATE. Congressman Pickle, I think the majority of employers will welcome this precisely because it does shore up the funding requirements. And in the long run, I think this is an excellent step to shoring up the defined benefits system.

Chairman PICKLE. Now, to get a graphic idea of the number of people who are at risk in that their pension could not be paid for, how many workers currently are participating in underfunded pension plans?

Mr. SLATE. Let me answer in two parts. There are about 8 million workers who are in plans that are underfunded. However, of those, only about 2 million are in plans of troubled companies.

Chairman PICKLE. But you have 8 million people who potentially could be affected and 2 million in the plans that are threatened.

Mr. SLATE. But, realistically, 2 million in plans that are threatened, yes, sir.

Chairman PICKLE. We have a $51 underfunded liability in single-employer defined benefit and in multiemployer benefit plans. There is $40 billion in the underfunded single-employer plans, and $11 billion in the multiemployer. How much of an increase is this from 5 years ago?

Mr. SLATE. In the single-employer universe, Mr. Pickle, it has gone up from 1987 through 1991 from $27 to $38 billion.

Chairman PICKLE. All right. Are there any large underfunded plans which you feel are reasonably likely to be taken over by the PBGC in the next few years?

Mr. SLATE. I think that there are likely to be terminations of large underfunded plans. I don't feel comfortable identifying those, but given the ebbs and flows of the economy, those things are likely to happen.

Chairman PICKLE. Well, do you feel comfortable in listing any of those companies?

Mr. SLATE. No, I don't feel comfortable. I don't feel that I should.

Chairman PICKLE. Could you give us an idea of how many plans, 10? 20? 50? 100?

Mr. SLATE. Our historical average is that between 80 and 100 plans a year are terminated without sufficient assets.

Chairman PICKLE. All right. Well, you made the mention in your statement that we had some offsets permitted and we had some bad assumptions in the 1987 law.

I assume that those loopholes caused a great deal of the underfunding in plans.

Mr. SLATE. Yes, to quote Secretary Reich, they allowed for an inordinate amount of wiggle room and people were allowed to take advantage of those loopholes.

Chairman PICKLE. I am going to yield to Mr. Houghton and then come back to you.

Mr. HOUGHTON. Thank you, Mr. Chairman. I have two questions to ask you right off the bat.

In your testimony you talk about three reforms. First of all, strengthen the formula; second, end double counting; and third, constraining assumptions. I personally agree with you on the end of the constrain assumptions, but you don't want to assume that you are going to double your revenue just because you put a different number on your paper and make the pension plan all right. Of course it isn't all right.

However, in strengthening the formula, you were talking about speeding up the basic contribution. You know the thing that bothers me about this whole plan, and maybe you have thought about this and have a better, broader concept than I have been listening to. There is a company, company X, let's call it, that is doing a good job, but it is underfunded, although not part of the 2 million that are in jeopardy.

All the sudden you get a break in the stock market, such as we had in 1987. Say it goes down 500 points. So it is moving up the scale toward total funding and now all of a sudden it is under. The reason that happens usually is because business is bad. You are talking about $12 billion of underfunding in plans sponsored by companies in difficult financial circumstances. That is sort of an oxymoron.

The question is: What do you do? You have a company that is on the right track trying to protect its pension system and trying to get funding and trying to move up to the scale that you want, that everybody wants, trying to protect its employees so that it doesn't have to cut out a lot of expenses. Yet because of nothing having to do with itself, it gets knocked down and it is way off the scale.

You have a procedure here, a certain time set that you have to speed up the funding and you don't have any maneuverability in that. That bothers me.

Mr. SLATE. Perhaps I can put you a little more at ease. Let me answer generally and then specifically about your concern. We too were very, very concerned about affordability and making sure that companies could meet their legal obligations to fund their plans, but at the same time continue doing business.

The Secretary appointed people to the task force, not just people with benefits responsibilities, but people with economic backgrounds, such as from the National Economic Council. We did many, many important models and we looked at financial data and balance sheets. We drafted rules that we think are effective, but also doable and affordable.

One thing we did was to put in a transition rule for the first 7 years that essentially caps the funding contributions that people will have to make and thus eases people into the new requirements. Now, that is the general answer.

Specifically, and perhaps I should have made this clear in my testimony, as you go up the funding ladder, as you go from 60 to 70 to 80 to 90 percent funded, the funding requirements on the schedule diminish. I doubt that companies that have been contributing and that continue to contribute will find themselves in trouble if, for a year or two they are in a situation where they can't be quite as generous as they were before.

For those that do not have severely underfunded plans, as I say, the curve goes down as funding goes up.

Mr. HOUGHTON. Yes, but can I continue a minute longer? You have the advantage.

You say here the plans will be funded within 5 years, and all of a sudden something happens totally outside their control. They want to do right, they are going to do right. They have a good sense of the protection of their employees, and yet physically, because of conditions beyond their control, they can't do it and there is no flexibility in this.

Mr. SLATE. There is a waiver process by which you can go to the IRS if you have a year or two where you can't meet your obligations, but you can do it in the future. Several hundred companies a year do go and use that process.

Mr. HOUGHTON. And that will be workable then?

Mr. SLATE. Yes, it is workable. The higher you are on the funding schedule, the less your requirements, and so I think the companies that have been contributing all along are not going to find themselves in a crunch.

Chairman PICKLE. Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman.

The Chairman indicated in his questioning and also you in your statement, there is a dollar amount of deficit for the PBGC as of 1992. And that deficit is $2.7 billion; is that correct?

Mr. SLATE. Yes.

Mr. KLECZKA. Further in your testimony, you indicate that the agency's annual revenues exceeded the benefits it must pay to retirees, indicating there is no deficit.

In simple terms would you explain to the committee and everybody else where you get the deficit of $2.7 billion?

Mr. SLATE. Sure. The $2.7 billion is a long-term deficit. These are the long-term debts that we would own if we stopped business today and paid out everything that we owed in the future.

On a day-to-day basis, we are taking in more cash than we are paying out.

Mr. KLECZKA. The $2.7 is a long-term deficit based on the plans that you have in now?

Mr. SLATE. Yes, as well as "probables"—those plans that accounting rules require us to treat as terminated on our books because of the high probability they will terminate during the year.

Mr. KLECZKA. If all the funding were to hit us in one particular area and the corporations that are not doing well shifted their liabilities to the PBGC, then we are looking at $50 billion of debt, which chances are unlikely, but nevertheless it is an underfunding dollar amount that we have to be concerned with.

Mr. SLATE. Certainly.

Mr. KLECZKA. No. We are talking about payments going to 8 million workers to the tune of some $50 billion.

Mr. SLATE. That is an extreme case.

Mr. KLECZKA. But let's use my extreme example. Clearly, you would not have the funds in the PBGC to make those payments. At that point where would you get the dollar from to make good on the Federal promise to pay these pensioners?

Mr. SLATE. The purpose of this legislation——

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Mr. KLECZKA. Just answer the question, I am aware of the legislation.

Mr. SLATE. At that point I think we would have to be turning to you. The reason we are here today with this bill is to deal with the situation while it is manageable.

Mr. KLECZKA. That is the point that I was trying to make not only to you, but I just came over from the Banking Committee before I got on this committee, and I think all of us in this room realize what happened to the FSLIC, and for the last year I was on that committee, every year was more and more and more.

And it wasn't that we were bailing out failed S&Ls, but we were making good on the Federal promise. And the pension funds that we are guaranteeing through the PBGC carry with it an identical or similar Federal guarantee.

And naturally we are not going to close down all industry in this country and have a $50 billion liability, but if in fact things would go from worse to worser, there is a possibility that we could be looking at $20 billion or $10 billion or whatever amount above and beyond what you have in-house and to take care of the benefits they would have to be made up by the taxpayer.

And I think the point I am trying to make is to point out the need for this legislation so we address over the next 5 years those plans which are causing us heartburn, which could provide for the fund to be in serious jeopardy.

And since I got on the committee, the chairman has not only had hearings on this, but meetings with the committee and he has tried to drive home the fact that there could be problems if we don't do something today.

And I think the chairman is correct. The administration has recognized this. So now we can take this overdue and fair legislation that you have brought forward and hopefully move it through Congress.

Mr. SLATE. I hope so too.

Mr. KLECZKA. That was a heck of a question, wasn't it?

Mr. SLATE. I think we agree.

Mr. KLECZKA. I do want to get into the entire question of the multiemployer plans, which I am led to believe make up for some 30 percent of the underfunding, however as I look at your proposal, there is no mention of any reform slated for that system.

Mr. SLATE. Let me talk about that first of all. I don't think 30 percent. I think it is far less than that.

Mr. KLECZKA. Could you give me a percent?

Mr. SLATE. I think it is about 20 percent. But having said that, we looked at this very, very carefully. We had a number of people with a stake in the multiemployer system visit with us, and our conclusion was that the problem was in the single-employer universe.

In the multiemployer universe, there was a law passed in 1980, the Multiemployer Pension Plan Amendments Act of 1980. Since its passage, the improvements have been substantial and dramatic both in funding and in limiting approaches to the government. Let me be specific there.

Funding in the multiemployer plans since 1980 has gone up from about 60 percent to 80 percent. Underfunding has gone down from

$33 to $11 billion. Since 1980, only 11 plans have come to the PBGC for assistance and we are in fact running a long-term surplus in the multiemployer program of $200 million.

So our conclusion, after fully looking at the multiemployer situation, is that legislative reforms are not needed there, that the 1980 act is working, and that we should proceed ahead.

Mr. KLECZKA. Fine, I will have some more questions on the multiemployer on the next round.

Chairman PICKLE. Mr. Lewis.

Mr. LEWIS. Thank you, Mr. Chairman.

Mr. Chairman, I want to followup on my colleague's line of questioning. I noticed, Mr. Chairman, your bill called for a reform of both the multiemployer and the single employer plan.

Mr. Slate, of the $51 billion in pension plans underfunded, $11 billion is due to underfunding in the multiemployer plan. You just told my colleague that you didn't see a need to address this problem.

Could you elaborate and tell me why you don't see a need to address the multiemployer plan problem?

Mr. SLATE. Yes, again, because although that figure is correct, it has gone down from $33 billion in the early 1980s to $11 billion as a result of the 1980 multiemployer act.

Funding levels have gone up from about 60 to 80 percent and there have only been 11 plans throughout this whole time that have come to the Government for assistance and we are running a surplus. This was not the area to which we thought reform should be targeted.

Mr. LEWIS. Can you tell the committee how many plans we are talking about; multiemployer plans?

Mr. SLATE. About 2,000.

Mr. LEWIS. And how many single employer plans?

Mr. SLATE. We are talking about 65,000. There is a much bigger universe of single-employer plans.

Mr. LEWIS. Thank you very much Mr. Chairman.

Chairman PICKLE. Thank you.

Now, we are going to start our second round of questioning, and I will go to a question that pertains to the payment of funds by companies which are underfunded.

Now, in our bill that we had recommended, H.R. 298, we had said that a sponsor would be prohibited from making any additional pension promises unless the plan was accompanied by collateral or cash in a certain amount.

Now, you do not make any provision like that in your bill. Can you tell me why? Why would you not say that——

Mr. SLATE. Yes.

Chairman PICKLE [continuing]. You would stop the underfunded plans from making more promises? The problem we have in the pension program is that, particularly in those companies affected by collective bargaining, they make more promises than they put in cash for.

That is the root of our problem. I don't think anybody has denied that. But you have no provision that they can't make more promises unless they put up cash. Why?

Mr. SLATE. We looked at this closely and we felt that such restrictions are unfair to workers and retirees. We felt that benefits should be paid for through speedy, strengthened funding requirements.

When it comes to salary or white collar plans, benefit increases are automatic and they are built into those plans. Rank and file plans do not have benefit increases built into them, nor do retirees generally have increases built into them.

So it would be unfair to deny people in these circumstances the opportunity for benefit increases. Benefit increases should be available, but they should be funded and should be funded rapidly. That is the message of our bill. If you negotiate benefit increases, they must be funded on a very fast track.

Chairman PICKLE. You are saying that the correction to this whole problem is speedy funding, but let them go ahead and make any promises they want?

Mr. SLATE. Our speedy funding rules should certainly be taken into account when they make their benefit increases.

Chairman PICKLE. That is your proposal. Instead of saying that you can't make promises unless you put up money, you are just saying make them fund speedily and that is all?

Mr. SLATE. We think it is unfair to rank and file workers and unfair to retirees to deny them the opportunity for benefit increases, provided the increases are funded.

Chairman PICKLE. Well, it may be unfair to workers, but it is also unfair to the pension fund, to PBGC. By way of review, as I recall it, the Bush administration said that you could not make any new guaranteed promises if you were an underfunded plan. Essentially, I think that is what they were saying.

The largest pension coalition we have in the country, ERIC, I think they would guarantee benefit increases over 10 years but they would require that the company fund them over the same 10 years, and your statement says clearly that you would not be in favor of that.

My bill said that you couldn't make any promises unless you put up 90 percent in cash or collateral. That is the recommendation of three major groups, and yet you have no recommendation. You said just more speedy funding, I think that is a problem that we have got to work out.

Mr. SLATE. Mr. Pickle, we are all going in the same direction in terms of speedier funding and benefit protection.

Our bill, of course, contains many, many comprehensive proposals that the Bush bill and the ERIC proposal don't include. Specifically the Bush bill and the ERIC proposal both cut guarantees. Reducing worker protection is unacceptable.

I think I have already talked about explicit restrictions on benefit increases and indicated that I think those are unfair to workers and unnecessary.

Chairman PICKLE. Well, I don't have to ask you then, you do not agree with ERIC's proposal? You don't agree with the previous administration's proposal, the Bush proposal, and you don't agree with my view. You just say require speedy funding.

How does the administration's, your, proposal deal with the mismatch of the promises versus funding?

Mr. SLATE. I think that with most benefit, increases being funded over a 5-year period, Mr. Pickle, we will be matching the Federal guarantee almost dollar for dollar. If these rules are followed, I think there would be a de minimis increase in the guarantee exposure.

Chairman PICKLE. I will come back.

Mr. Houghton.

Mr. HOUGHTON. I would like to followup if I could, Mr. Chairman. I am going to let you come up for air Mr. Slate and ask Mr. Hardock from Treasury a question.

Let me say at the beginning though, that philosophically, we are sitting here asking you questions and you could be sitting here asking us questions with our Social Security system.

I hope that out of this comes a realization that we are all at fault, it is not just what you are doing, but what all of us are doing. I am very worried about it.

As far as the Treasury was occurred, was the Treasury involved in the planning here? Did you agree with what was being done? Did you agree with the conclusions?

Second, what about the people that are creating jobs? What about the smaller business opinion? What is going to happen?

Mr. HARDOCK. I think there are two points. The first is that Treasury was very active in this process. A large team of people have been working on the task force for many, many months, including lawyers, actuaries, accountants, economists, everyone we could bring to bear.

This was a very high priority for Secretary Bentsen and we believe that this will bring the long-range improvement in the PBGC's status that you Mr. Chairman, and the members of this committee, want to achieve.

Turning to what it will do for the small business owner, I think you have seen, at least on some occasions in the past, where a small businessman was maintaining a defined benefit plan for the benefit of his employees and the PBGC flat premiums kept going up. His plan was overfunded and he wasn't presenting a risk to the PBGC, yet his premiums kept going up and up and up to pay for the PBGC deficit.

This bill doesn't adversely affect you if you fund your programs. That should encourage some not to drop their defined plans and so in that sense I think is a plus.

Mr. HOUGHTON. One of the issues that keeps dangling out there, Mr. Hardock, is the overall cost scheme of a small business in today's overall climate, and you have increased taxes that are coming down the pike. You have to worry about the increased costs that are coming with health reform.

And if you have a dip in the stock market and the value of your pension assets goes down, then you have this rather strict hobbling of the pension controls. Have you thought about that?

Mr. HARDOCK. Yes. Let me point out one thing that is true of the deficit reduction contributions under the current funding law. The problems the PBGC has had in the past have resulted from large employers terminating underfunded plans.

Essentially the decision was made that small employer plans were not creating a big problem and that, since this was added

complexity in 1987 and today, that those smaller plans would not be subjected to the more stringent new funding rules.

Chairman PICKLE. Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman.

Mr. Slate, you indicated that increased benefits in various retirement systems should be funded on a fast track. In a perfect world, I believe that would be the way to do it.

However, in a recent GAO report it indicates that the PBGC does not do a good job in identifying plans which are in trouble and by the time they do identify these plans, it is too late and they are already into PBGC for payment.

Could you respond to that?

Mr. SLATE. I am not sure what report you are talking about.

Mr. KLECZKA. The GAO report of last Friday, 293–21.

Mr. SLATE. They are simply referring to multiemployer plans, which is a very, very small part of our universe. What we have done over the last few months is set up an electronic inventory system for identifying multiemployer plans that are in difficulty and enhance our controls.

That report, frankly, was as of September 30, 1992. The GAO made us aware of those problems some time ago and we have been working with them. I think we have that situation very much under control.

Mr. KLECZKA. I am still concerned that multiemployer plans are not included in here as well as some of my colleagues are also concerned. When we changed the law in 1980, we provided for a withdrawal liability. At that point it was our understanding that we had somehow fixed the system.

Let me ask a question on that portion of the multiemployer plan. By requiring a company to pay its proportionate share of unfunded liabilities, any multiemployer plan in order to withdraw from the system should have strengthened the multiemployer plans.

Now, I understand this has had just the opposite effect. The plan trustees now tend to increase benefits at a rate faster than the companies increase contributions. As a result, the unfunded liabilities of multiemployer plans continue to grow.

That increase in turn makes each employer's share of the unfunded liabilities larger, which makes the withdrawal payment larger and larger. Then this makes it prohibitive for the company to withdraw from the plan.

So clearly our law change in 1980 had little effect unless we do something about tightening up what the trustees of the plans can now do to increase benefits without a subsequent increase in the contributions.

Mr. SLATE. The task force's conclusions would disagree with that statement. As I indicated, underfunding has gone down from $33 to $11 billion over the past 10 years and funding has gone up from about 60 to 80 percent. Our sense was that changes were not called for.

Mr. KLECZKA. Is it not true that trustees are increasing benefits without a comparable increase in the contributions?

Mr. SLATE. If you look at overall underfunding, it has gone down, and the overall funding rate has gone up, that just could not be so overall.

Mr. KLECZKA. Have you seen that on a single employer basis, one group of employers in a multiplan?

Mr. SLATE. No, but I don't want to suggest that I am familiar with every one of them.

Mr. KLECZKA. On average you say it is going down. But if you look at it group by group, I am wondering where the problems might be occurring.

Mr. SLATE. I don't have anything specific on that. We did look at a lot of employers and our conclusion was that the situation was moving very much on a positive vein.

Mr. KLECZKA. Thank you.

Chairman PICKLE. I want to ask, in line with that question with respect to the multiemployers, you do not make any recommendations. Do you have plans afoot to that would be making recommendations in the multiemployer field?

Mr. SLATE. No.

Chairman PICKLE. So you do not intend to make any recommendations this year on the multiemployer field?

Mr. SLATE. No.

Chairman PICKLE. They do have $11 billion in underfunding. Apparently they may be going in the right direction, and, as long as they are going on the down slide, you are not going to let them alone?

Mr. SLATE. We are not going to let them off. I understand that $11 billion is a 1991 figure. In some of our samples for 1992, the funding levels may even go up for some plans. We are not going to make any recommendations in that area, no.

Chairman PICKLE. Mr. Lewis.

Mr. LEWIS. Thank you, Mr. Chairman.

Mr. Hardock, are you convinced with the passage of this plan beyond a shadow of a doubt that you, as part of this administration, will not come back here in 5, 6, or 10 years saying, please, Congress people, we need a bailout for PBGC?

Mr. SLATE. Mr. Lewis, we took the time and the Secretary appointed a broad array of experts precisely so that we could put together something that was workable. We have identified clear structural problems in the current law. We think our reforms would inject certainty and speed into the funding.

Mr. LEWIS. Mr. Slate, I am concerned. You know in another period in the history of our country we heard about speed. Back in 1954 when the Supreme Court issued that great decision May 17, 1954 and they came back and said with all deliberate speeds. We are still speeding.

I want you to slow down for a moment and convince me and convince members of the committee that this is really a guarantee that you will not come back here somewhere along the way, that this proposed package is a guarantee, is an assurance that we will not need a bailout.

Mr. SLATE. That is precisely why we took the time and put the experts on it. We started by looking at it, doing a number of studies of a number of companies. We have identified the clear problems with the law and we think we have addressed it in a very clear, discrete way.

If you look at that chart, that chart is a result of our work if enacted. I believe funding will go from 55 to 90 percent over the next 15 years.

Mr. HARDOCK. Mr. Lewis, let me add one point. We spent a great deal of time, as Mr. Slate pointed out, looking at different ways of addressing this problem.

Ultimately the decision was made to build on what was there because we knew what was wrong with what was there. We could have tried something completely different, but the thought process was that new loopholes would be found and new ways around whatever rules were adopted.

What the task force tried to do is take what was there, fix the problems with what was there, and tighten the rules, and think ahead to the extent possible with rules like requiring approval of changes in actuarial assumptions to make sure that these rules did work.

There are no guarantees. In the tax area we learned the ingenuity of tax planners and in some cases the ingenuity of people who may not want to fund their plans.

We know this is a major step forward. Much more money will flow into plans and the PBGC's exposure will reduce dramatically, hopefully to the point where we will never have to come back.

Mr. LEWIS. Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Brewster.

Mr. BREWSTER. Thank you, Mr. Chairman.

Mr. Slate, as one who is not as optimistic about your chart as you are, the chairman a moment ago asked you about why there was not a prohibition on companies expanding benefits if they were not at least 90 percent funded, why they should be allowed to expand benefits if you were underfunded.

Your answer was that United States felt it was not fair to workers if they were not allowed to expand. Is it fair to other workers who are taxpayers in this country for an underfunding that may have occurred down the line, for an underfunded company to expand benefits for its workers?

Mr. SLATE. The rules guarantee that the exposure will not be increased. The funding rules more or less mirror that guarantee. So this should not affect other workers. My sense—and I have gotten a very clear sense over the last few days—is that most people in the benefits communities welcome this approach because it will shore up the defined benefit system and make it more attractive for all workers.

Mr. BREWSTER. If the company is 50 or 60 percent funding and wants to grant employees future benefit expansion without funding it, can they do so?

Mr. SLATE. They better fund it. That is what the reforms will say, they must fund them and fund them swiftly.

Mr. BREWSTER. But there is no prohibition. The chairman's bill says unless they are 90 percent funded, you cannot expand benefits.

Mr. SLATE. We believe that is unfair to workers and unfair to retirees.

Mr. BREWSTER. If the company is 60 percent funded, they can do so, expand the benefits without funding them.

Mr. SLATE. They had better fund them. They must fund them over a 5-year period.

Mr. BREWSTER. If they are 60 percent funded, they can increase the benefits and say they are going to fund them over 5 years?

Mr. SLATE. I think that is really not a likely case. I think you have to give the people who negotiate it more credit for making economic projections. We built economic projections into our funding as well. It goes from 55 to 90 percent.

Mr. BREWSTER. I remember the early 1980s, the changes in S&L laws and what happened. No one believed it would come to what it has. That is my concern on this. You say you don't think those who make the negotiations would get into that posture, but we are $150 billion underfunded now.

Mr. SLATE. The difference between this and the savings and loan situation is that thanks to the leadership of this committee, we have caught the situation long before it is critical, while it is still manageable.

Our conclusion is that if we have specified certain funding levels, average funding rations will rise to 7 percent in 5 years and 90 percent in 15 years and we will avert an S&L-type crisis by a mile.

Mr. BREWSTER. We will have an opportunity to visit about this at a later time and see how it plays out.

On the premium side, I notice that currently there is a $53 variable rate cap and the cap is being removed in your legislation correct?

Mr. SLATE. Yes. It would be phased out through 1997.

Mr. BREWSTER. What will be the impact of the premium cap change on companies, really highly affected companies such as General Motors?

Mr. SLATE. We looked at all this. Removing the cap is very important because it provides an incentive for funding. We tried to make it affordable in the short run; our hope is that in the long run, as the funding goes up, the premium requirements will go down. We look forward to the time when companies will no longer have to pay the variable rate premium.

Mr. BREWSTER. Say it is General Motors, if we are removing the cap of $53 what would be their likely cap?

Mr. SLATE. I don't have that specific data on a company. Plans that are severely underfunded right now pay a total of the $72 in premiums, $53 for the variable rate and $19 for the flat rate. The average for people at the cap would be $140 per participant.

Mr. BREWSTER. Will the premium increase be sufficient to eliminate PBGC's $2.7 million deficit?

Mr. SLATE. We look at the whole package, the decline in risk in underfunding and the enhanced premiums. Projections in this business are only projections, but our sense is that over 10 years it will eliminate the PBGC deficit.

Mr. BREWSTER. How will they increase compared to the increase in planned contributions? Is there a correlation between the two?

Mr. SLATE. Yes. I think that you are talking about an increase in premiums that us about 20 percent of the increase in funding.

Mr. BREWSTER. Thank you, Mr. Chairman.

Chairman PICKLE. Thank you. I want to repeat the question once more to get a clear answer. What will be the function impact of the

premium cap change on the variable rate with respect to companies like General Motors?

Mr. SLATE. I don't have a specific dollar figure for General Motors. What I am saying—and let me repeat it again—plans currently at the cap would go from a total of $72, $19, flat $53 variable, to a total of $140 on average.

Chairman PICKLE. You think that would be manageable for companies like General Motors?

Mr. SLATE. Yes. These companies, for every dollar increase in premium they would pay, they are paying $251 in dividends. So I think the amount of money, while it will provide incentive for more funding, is affordable.

Chairman PICKLE. Thank you.

Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman.

Mr. Slate, could you tell me what the revenue effect of the administration's proposal will be? Is it revenue neutral or——

Mr. SLATE. Absolutely, it is revenue neutral. The cost of the 5-year period would be approximately $2.7 billion, about two-thirds of that would be made up through premiums and the other third would be through various other pension changes in the Tax Code.

Mr. HERGER. Could you tell me a little about the proposal, it does repeal the rules applicable to age-based retirements plans? Could you tell us why this was done, how your proposal would work?

Mr. SLATE. I would like to defer to the Treasury on that.

Mr. HARDOCK. We have found sizable tax shelter opportunities for high paid older workers in these types of plans. These abusive plans provide very little benefit to rank and file workers.

Some of the headlines in the literature are, I think, instructural. Under the heading of strategic planning, we found the headline "Skewed retirement plans help owners at workers' expense." Another one that I saw said, "Age-weighted profit sharing plans allow large contributions on behalf of older physicians who will be retiring soon."

The Wall Street Journal wrote it up a little bit differently. "Small firms retirement plans are turned into owner's bonanza."

Basically, there are four reasons we believe these plans should be limited.

The first is that it hurts the rank and file employees who will not be getting meaningful benefits under these plans. In many cases they may get no benefits at all.

Second, in some situations, the establishment of this type of plan can discourage the hiring of older workers.

A third issue is the integrity of the pension system and the defined benefit system.

And the fourth issue is whether or not in many of these cases the tax subsidies going to the highly paid employees is worth it given the very, very marginal benefits provided to the rank and file workers.

All of these reasons we believe support the proposal to cutback on cross-testing of these plans.

Mr. HERGER. Thank you, very good.

Chairman PICKLE. Mr. Brewster, do you have any further questions?

Mr. BREWSTER. Yes, Mr. Chairman.

I guess I am a little confused. I heard an answer to my friend, Mr. Kleczka's question concerning multiemployers earlier. You indicated that a drop from $30-something billion down to $11 billion today.

According to the figures I have in front of me, the total underfunding for 1988 was $20 billion. Maybe I don't understand, but how was that $33 billion 5 years ago—if 5 years ago total underfunding was $20 billion—now $20 billion?

Mr. SLATE. That $33 billion figure was shortly after the Multiemployer Pension Plan Amendments Act of 1980. It might be a 1980 or 1981 figure. But my point was that since the Multiemployer Act was passed in 1980 overall there has been a decline in underfunding in the multiemployer universe down to $11 billion.

Mr. BREWSTER. I thought I had seen some figures that showed it had gone back up since about 1981. Is that not correct?

Mr. SLATE. As far as we can determine, and we are keeping an eye on this, it is because of the drop in interest rates and that the overall trend is toward increased funding continuing.

Mr. BREWSTER. Thank you.

Chairman PICKLE. Let me try to establish some of the overall attitudes here on the Hill. You made this recommendation. And other committees will have a hand in trying to decide what course we will develop.

Can you give me an indication of what other committees here on the Hill will do? Will they support this proposal of yours?

Mr. SLATE. I cannot speak for the committees. We are prepared to work with all committees of jurisdiction.

Chairman PICKLE. Have you had any indication that committees like Education and Labor might oppose it?

Mr. SLATE. No. We have met with their staff as I met with your staff.

Chairman PICKLE. Does the administration want its reform enacted this year?

Mr. SLATE. This administration wants these reforms enacted speedily. The answer is yes.

Chairman PICKLE. Then what would be the effective date, upon passage?

Mr. SLATE. The effective date, Mr. Pickle, for most provisions, and there are some exceptions, would be January 1, 1995.

Chairman PICKLE. Would these proposals affect the recent auto industry negotiations? Have the Ford negotiations established any guidelines that will be affected by this legislation?

Mr. SLATE. Mr. Pickle, the rules go into effect in 1995. They do pick up the benefit increases in 1993 and 1994. So they would include those auto increases.

Chairman PICKLE. What was the increase in the negotiation with the Ford Motor Co.?

Mr. SLATE. I believe it was 13 percent over 3 years. In our modeling, we built in an increase that works right around that figure.

Chairman PICKLE. If I understand you, you are saying they are going to have a 13 percent increase in the next 3 years?

Mr. SLATE. Yes. It is about 4 percent a year.

Chairman PICKLE. Did the company put up the extra money to cover that?

Mr. SLATE. Our rules would require that the company fund those benefit increases.

Chairman PICKLE. If I understand you, you are going to require that they meet those funding requirements, but yet you don't propose that other companies do that?

Mr. SLATE. We propose that they all meet those funding requirements.

Chairman PICKLE. Then I am confused. I understood you were saying that a company could enter into negotiation and make additional promises but not put up funding for them.

Mr. SLATE. Let me be clear. We are opposed to explicit restrictions on benefit increases. We are advocating speedy certain funding of any benefit increase and that includes the ones of 1993 and 1994.

Chairman PICKLE. You go back to the same premise that you don't want restrictions on the labor benefits and you want to speed funding up. That would satisfy your requirements. But you are not saying that you would prohibit a company from making promises and not putting up any extra cash for it.

Mr. SLATE. I think you pretty well stated that, yes.

Chairman PICKLE. Mr. Houghton.

Mr. HOUGHTON. I would like to go back to you, Mr. Slate. If you want to share the answers with Mr. Hardock and Ms. Schub, that is all right. I really have two questions.

First of all, part of your reform is to have pension plans which are less than 60 percent funded kick into this 5-year rule as contrasted to the old stipulation where they were 35 percent funded. That is an interesting jump. That is a tough jump for somebody who is in business.

The second point, and maybe more important, is that you know the economic atmosphere is a psychological atmosphere. It is not just numbers, statistics, and leading indices. So the fewer new laws that we can superimpose on those people who are trying to create jobs, the better.

Now, you said in an article here, and I am quoting you, that "we can assure the people who are about to retire that their pensions are safe." Also there is a further quote, "we are in a position to see that pension promises are kept."

You also have set up some sort of a watchdog committee. It sounds good, sounds great, that is, if anything is veering toward the cliff, then you can help try to pull it back.

But you said also that the real financial problems are there even if their impact is years away. Why do you do anything now? People are scared. Why don't you just wait a little bit on this?

Mr. SLATE. I think it makes sense to deal with the situation now in an orderly balanced way while it is still manageable. I think the lesson we learned from the savings and loan was that we waited too long.

What we can be thankful for here is that people like Mr. Pickle have called this issue to our attention at this relatively early point.

Underfunding is going up. The PBGC deficit is going up. But it is manageable now and that is why we are proposing firm, orderly and balanced steps now.

Mr. HOUGHTON. What about the specific 35 to 60 percent?

Mr. SLATE. Because there are many plans that are severely underfunded between that 35 and 60 percent range, we think the funding has to be hiked up. That is why we raised it.

I want to emphasize we put in a transition rule over the first 7 years so that to the extent that there are disproportionate or undoable increases, those would be capped by the transition rule.

Chairman PICKLE. I will follow that up just briefly. With Mr. Houghton's question about the 60 percent level of funding, can you tell me how many additional plans will be required to fund pension liabilities over 5 years as the result of the administration's proposals?

Mr. SLATE. I think we are going to have to submit that one for the record, sir. I will get you very precise figures.

[The information follows:]

The majority of the impact of the new funding will be felt by 150 firms that sponsor plans with about 85 percent of the underfunding. Approximately 750 firms could be required to contribute $1 million or more over 5 years ($200,000 per year).

In total, there are about 6,000 underfunded plans with more than 100 participants each. Of these plans, about 5 percent have funding ratios of less than 35 percent and slightly less than 20 percent have funding ratios between 35 and 60 percent. The transition rule would ease the impact of the proposals on some of these plans.

Chairman PICKLE. Can you give me an estimate? Can one of your staff give you a general estimate? I am trying to get the scope on it.

Mr. SLATE. No. What I can tell you is that most of the impact of these rules will be on about 150 companies, but I don't want to jump the gun on that. I would appreciate your letting me get you the numbers for the record.

Chairman PICKLE. All right. What percentage of all unfunded plans will be covered by the 5-year funding rule? In other words, what percentage of all plans are less than 60 percent funded?

I am not asking for total numbers. I am asking for percentages, if you can give me that.

Mr. SLATE. The figure is less than half of all the underfunded plans, but I will give you that figure. As I say, the real impact of this law will be on about 150 companies.

Chairman PICKLE. Can you tell me about a typical company with an underfunded plan have contributions increased by 1 percent, 10 percent, 50 percent, what percent?

Mr. SLATE. The chart shows that on an average over 5 years the funding ratios would go from 55 to 70 percent, and over 15 years, it would go from 55 to 90 percent. That is a very representative sample.

Chairman PICKLE. Thank you.

Mr. Kleczka.

Mr. KLECZKA. Mr. Chairman, I have one final question and it is a result of a hearing we had on this issue earlier this year where a gentlemen appeared before us who had worked for a company I believe somewhere in the Midwest, Ohio sort of rings a bell. I think he took early retirement wherein he would have a good supple-

mental benefit and naturally the basic retirement benefit, so he thought he was all set for his retirement years.

Lo and behold, his company went into bankruptcy or the plan was shifted over to the PBGC and he lost almost everything except the basic plan which was subsequently cut.

When we questioned this gentlemen, he never knew in a million years that the company plan was underfunded. He never knew that. He may have made a different decision on retirement. Nevertheless, you have a provision in the bill that provides for some participant disclosure requirements.

Could you give the committee a little feel for what you are proposing in that section so at least the person who is getting a pension benefit and one that is being increased year after year knows whether or not the company can afford to do that, and so they can make a judgment as to whether it is a hollow promise or if it is going to be a benefit that is going to be received upon retirement.

Could you give us the disclosure requirements you are talking about and what recourse the employee might have should the company be severely underfunded?

Mr. SLATE. Mr. Kleczka, first let me say that I remember well that you raised this in the hearing last spring. I think you did us all a service. It focused on this issue and I think we have addressed it squarely.

Mr. KLECZKA. I thank you for putting it in the bill, naturally.

Mr. SLATE. Yes, of course. I know with your help it will stay there.

Mr. KLECZKA. Or get toughened up. Could you identify for the committee what you are talking about though?

Mr. SLATE. Basically we are going to require companies with unfunded plans, on a yearly basis, to inform their employees quite precisely as to what their funding situation, is and also to explain to them the PBGC guarantee and, to the extent possible, how that PBGC guarantee might apply to them.

We will require that the information be in clear, plain language. PBGS will issue a model notice and regulations very shortly after passage. We would be delighted to share that material with the committee before it goes out so you can give us whatever assistance you can in terms of developing the language.

Mr. KLECZKA. The important point is clear, concise and simple English so the employee knows what you are talking about. So don't model it after the Federal IRS regs. Sorry folks.

The last question is, is there any recourse for the employee should the plan that he or she is covered by be almost insolvent or totally underfunded? What can they do, call the employer or what?

Mr. SLATE. I think the answer to that is that they can call the employer. They can call it to the PBGC's attention. They can call it to the IRS' attention. That would help the agencies. The agencies would look at the employer and see if all the rules are being followed. We would try to work with the employer to improve funding.

I think that there would be any number of avenues of recourse.

Mr. KLECZKA. I don't see that as recourse. There is no sense in notifying you. You are the one who just sent the notice out that the plan was underfunded.

Mr. SLATE. No. The notice would have to come from the employer. We would require the employer to provide the notice. But let me say another thing. I mentioned in my oral testimony that we have an array of enforcement proposals in addition to those I talked about.

One of those enhanced enforcement proposals is that the PBGC have authority to go in and enforce the funding rules.

So if we get a letter from an employee of a particular company and we look at the company's reports and see that they in fact have not met their funding obligations, we can call the company and be right in Federal court and enforce those contributions.

It is a very important feature of the bill.

Mr. KLECZKA. Who's going to be responsible for the information being accurate that comes from the employer to the employee? Is IRS going to have some hand in that?

I am assuming most employers are not going to go out and say, hey, folks we have real problems here, but know full well that over the next 3 years, we are going to give you another 14 percent benefit increase in your pension.

Mr. SLATE. The PBGC will be responsible, Mr. Kleczka. This is going to be a title IV provision, and we will be responsible. There is a discrete universe of people and this is something we will enforce.

Mr. KLECZKA. Thank you very much.

Chairman PICKLE. Mr. Lewis, do you have any additional questions?

Mr. LEWIS. I have no further questions, Mr. Chairman, thank you.

Chairman PICKLE. Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman.

Mr. Slate, as you know, actuarial assumptions and other technical rules allow companies to have control over the amount of their pension contributions.

In some cases companies have manipulated these assumption rules to their benefit. Could you tell me how your proposal would address these problems and how your proposal would address interest rate and mortality rate assumptions?

Mr. SLATE. Sir, our proposal would address these head on. I do agree with you that there has been a substantial amount of wiggle room, that is what our task force concluded. The proposals would require that companies in underfunded situations use specified interest rate and mortality assumptions in order to inject certainty into the funding pattern of the plan.

Mr. HERGER. Thank you.

Chairman PICKLE. Can you tell me what the rate would be?

Mr. SLATE. For the mortality, we would use GAM 83, which is the mortality table that is commonly used in the insurance industry. For the interest rate, we would have a corridor of 90 to 100 percent of the 4-year average of the rates of interest on 30-year Treasury securities. So GAM 83, and 90 to 100 percent of the 4-year average rates of interest on Treasury securities.

For other actuarial assumptions, if employers in certain underfunded situations wanted to make a change which would essentially operate to their favor and diminish contributions, they would

have to apply to the IRS for approval. But for interest rate and mortality assumptions, which are the major factors, we have specified assumptions.

Chairman PICKLE. I am glad to have some general idea of how you specify closing these loopholes. These loopholes were not intended in 1987. They were not advanced by this committee, but they got slipped in over in the conference room somehow or another and it has become a big, wide loophole.

In your judgment, you have all the loopholes closed as far as you can tell and you are going to enforce them rigidly, as you say, meet them head on?

Mr. SLATE. Yes, sir.

Chairman PICKLE. Thank you, Mr. Herger.

Mr. Houghton.

Mr. HOUGHTON. Just a statement and a question, Mr. Chairman.

The thing that I worry about is that this is a very well thought academic plan. I know you don't feel it is and it probably isn't. But I have been through in my life enough ups and downs, particularly the downs, to know that the best intentions of Government sometimes run afoul of the practical conditions out there.

I hope you have enough flexibility in your system for somebody who has the right intentions and is moving in the right direction so he doesn't get caught up in a lock step with a rule that really will hurt the economy.

The only other question I have is this: The men have been doing all the talking today and Mrs. Schub has not done anything. Do you have a statement you would like to make, Mrs. Schub?

Ms. SCHUB. No, Congressman Houghton. I would like to reiterate that we believe this is a balanced proposal and that we took into account both the need to fund pension plans with the rest of the needs of a company to continue to operate and to continue to employ people. Thank you.

Mr. HOUGHTON. Thank you very much.

Chairman PICKLE. I have a few additional questions I want to come back to just to kind of make the record. I am not sure that I understand how the 3 percent limitation on the funding would work.

Can you tell me the purpose of that 3 percent limitation and give me an example of how it works?

Mr. SLATE. I am glad you asked. That is the transition rule. Basically, for a plan that is less than 75 percent funded the 3 percent rule would apply for 5 years and then a 4 percent rule for the next year and a 5 percent rule for the seventh year.

That means that after adding up his funding requirements under the new law, if an employer has to put in an amount that would raise its funding ratio by more than 3 percentage points, he can cap the funding at the amount necessary to increase the funding ration by 3 percentage points.

Let me give you an example. Suppose you were, as the typical employer on that chart is, at 55 percent funding. You figure out your funding amount and it would require you to put in an amount that would bring it to 59 or 60 percent. We would say that you could cap that contribution at a level that would require you to come in at 58 percent.

So the first year you would cap it at 58. Then the next year you would go to 61 and the next year to 64, et cetera. It is a transition rule on percentage points of underfunding.

Chairman PICKLE. Now is that just an arbitrary figure that you have taken, 3 percent?

Mr. SLATE. It could have been, but what we tried to do, Mr. Pickle, was look at corporate cash flows, financial data, contribution rates, and similar data and come up with a rule that would clearly accelerate and increase funding but at the same time would be affordable. That is how we came to that figure.

Chairman PICKLE. Let's say 3 percent is what you agreed to and what you have advanced and that is what you want. Will there be any waivers granted under this rule?

Mr. SLATE. The Internal Revenue Service, sir, has a waiver procedure. That would presumably apply to the 3 percentage point requirement. As I say, you must establish hardship, need, and ability to pay in the future.

Chairman PICKLE. Well, we have gotten into this trouble by granting waivers and I would hope that they put a stop to that. What is your intent?

Mr. SLATE. I don't direct the Internal Revenue Service program anymore, sir, so I will turn to the Department of Treasury. My feeling is that the Internal Revenue Service has been pretty vigilant over the last 4 years.

Mr. HARDOCK. Mr. Pickle, as you recall, prior to 1987, waivers were granted much, much more easily than they are today. The legislation you started in this committee actually tightened those rules more substantially.

We believe that the waiver rules now in effect are sufficiently tight to prevent overuse but do provide the flexibility that Mr. Houghton has been talking about for employers who perhaps had a bad year or two and simply cannot make their contribution. So it provides the opportunity, a safety valve, if you will, to keep people out of bankruptcy.

Chairman PICKLE. Well, we wouldn't want that. But we also must guard against the issuance of waivers. I take it from what you said, rather than what the IRS already allows, that you are not going to be looking favorably on any kind of waivers. This Congress would not be either.

Let me ask you another question. The administration's proposal would require underfunded plans to maintain assets equal to at least 3 years' benefits and other disbursements.

How does the administration proposal restrict these significantly underfunded plans from worsening due to new benefit increases?

Mr. SLATE. Mr. Pickle, that is the rule that I referred to in my testimony, the solvency rule. What that basically says is that any time a plan's assets go below 3 years' worth of benefit payments, it must, on a quarterly basis, replenish those assets. There would be immediate funding in that situation. For any quarter that a plan's assets are below 3 years' worth of payments, the employer immediately must fund up to that level.

Chairman PICKLE. There are some companies that had funds in their plan and they depleted those funds and they depleted them

pretty rapidly. Can you tell me what has been going on in the past with regard to last-minute depletion of a plan's assets?

Mr. SLATE. There have been a couple of very serious cases. That is exactly why this provision is put in. We will establish a floor on the amount of assets at 3 years' worth of payments. Once any company gets down to that, they won't be able to make lumpsum payments, on other kinds of payouts other than monthly payments unless and until they replenish their plans.

Chairman PICKLE. Well, if you are going to limit them from doing that, how do you limit that? Do you have the authority to make them make full payments or make these adjustments?

Mr. SLATE. We have a lien authority. We can put a lien on their assets.

Chairman PICKLE. Do you have a law to say to these companies that you cannot do that, but you can do this?

Mr. SLATE. This is our proposal. This would be our reform proposal, to require that they replenish their assets, and if not, we would put a lien on them.

Chairman PICKLE. Then you are going to enforce your authority, so to speak, by putting on a lien or termination or whatever you want to do?

Mr. SLATE. We intend to enforce it. We intend to keep an eye on those companies that are in that situation and to enforce it.

Chairman PICKLE. I hope it can work. Do you think we need to strengthen your authority in this bill any more specifically other than just the right you have of carrying out pension lawd with a lien?

Mr. SLATE. The solvency proposal also imposes excise taxes and civil penalties. At the moment, no other needed strengtheners occur to me. But if one thing ought to come through here, it is the administration's interest in giving the PBGC maximum compliance authority. And if there is something that comes up as we move this forward, Mr. Pickle, we are very open to discussing it.

Chairman PICKLE. I am going to go back to one of my first questions. I don't want to hold you, Mr. Slate. But I am concerned about the defined benefit program, the number of plans is not increasing. They are going down in a decline. Maybe these changes will give you protection.

I don't oppose the contribution plans, but I am concerned the incentive or the lure will be to go out and create a contribution plan and gradually phaseout or freeze the funding of the defined benefit plan and, in time, let that program go out of the way.

If so, then millions of workers' benefits will be taken. It is all right to have a contribution plan, but I want to be sure that they cannot have both unless they are both fully funded and that is understood. Is that your intent?

Mr. SLATE. Our intent is to have companies with underfunded defined benefit plans fund those plans and fund them speedily and certainly. Our clear sense is that that will make the defined benefit system more attractive.

Chairman PICKLE. I will try to conclude my summation in this manner. This committee has contended that the pension program is in great difficulty and that, while we do not have a crisis at this moment, we do have funding to stretch out over a few years. If we

don't make corrections now, the retirement benefits of millions of workers could be lost. We have to make some changes and we better make them now while we can do it.

We have been contending that and I think the public attention has come to that conclusion. The proposals that you have made, in my judgment, are good proposals. I am glad to see your Secretary stepping out and advancing some strong proposals that would close these loopholes, give the workers the information that they should have, and see that the funds are in the benefit plan.

I am still seriously concerned that you would allow these companies to make promises for increased benefits but not put up any additional money for them at the time. I think that is a fundamental flaw or weakness that should be addressed. I am not sure how we would go about that. I know different proposals have been made.

But, the problem we have that has caused all the difficulty has simply been promises that have not been funded.

Your approach is to speed up the funding. I think that will help a great deal. I am not sure that that, itself, will be enough. I like very much the proposal changes you have made about information for employees. I like the 3 percent for 3 years. I like the speeding up.

I believe you have a proposal that can be addressed and it is time to do that. I believe that this committee now should go to work to address the problem and see if we can advance legislation. You are making a recommendation that we do put together legislation to try to correct this program. Is that correct?

Mr. SLATE. Yes, Mr. Pickle. We are proud of the administration's proposals. We think it stands up there with the best of them. We are prepared to work with all the committees of jurisdiction in enacting a law. We think this is the time to do it while the situation can be addressed in a reasonable fashion.

Chairman PICKLE. Mr. Houghton, do you have any other questions or comments?

Mr. HOUGHTON. No, thank you, Mr. Chairman.

Chairman PICKLE. All right. We will adjourn this committee and we will go to work immediately for further hearings and try to advance this legislation.

Thank you very much for your testimony. The committee stands adjourned.

[Whereupon, at 3:50 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

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December 3, 1993

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RE: Pension Underfunding and the
<u>Pension Benefit Guaranty Corporation</u>

Dear Senators Kennedy and Moynihan and
Representatives Rostenkowski and Williams:

The financial weakness of the PBGC and certain portions of the private defined benefit pension plan system have received increased attention during the last several months. Congressional hearings were held on these issues in the summer of 1992 and again in 1993.

The Committee on Employee Benefits of the Association of the Bar of the City of New York (the "Committee") would like to express its

views on the important subject of the underfunding of defined benefit pension plans and its impact on the PBGC.

The PBGC's annual report for fiscal 1991 included a deficit of approximately $2.5 billion primarily attributable to the single-employer termination insurance program. Although the majority of single-employer defined benefit plans are adequately funded, there is an identifiable group of perennially underfunded large plans, most of which are concentrated in the airline, automobile, tire and steel industries. A recent estimate of these plans' funding shortfall is $40 billion.[1]

Legislation has been proposed several times over the last 24 months on pension underfunding, including the Clinton Administration's recently introduced package, HR 3396, the "Retirement Protection Act of 1993". HR 3396 includes several thoughtful proposals. This Committee intends to review HR 3396 in its entirety as it is considered by congressional committees during the coming months, and analyze it in a separate report.

The purpose of this comment letter is to discuss and evaluate several changes suggested in proposed legislation or by commentators, including certain provisions of HR 3396. However, discussion of provisions of HR 3396 concerning age-weighted profit-sharing plans is omitted, since they do not directly bear on defined benefit plan underfunding. The letter consists of four parts: (i) conclusions and recommendations; (ii) a summary of the major policy issues which must be balanced in addressing the funding problem; (iii) a review of several proposed measures; and (iv) an analysis of the different approaches.

CONCLUSIONS AND RECOMMENDATIONS

The Committee believes that four measures best balance the policy objectives implicated by the subject of pension underfunding: (i) limiting benefit increases unless a plan's funding level is increased or security is provided; (ii) requiring plan sponsors to contribute annually an amount at least equal to the prior year's benefit payments; (iii) tightening standards for granting minimum funding waivers and increasing the PBGC's role in the granting of such waivers; and (iv) improving the PBGC's premium enforcement and collection mechanisms. These recommendations are narrowly drawn to

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[1] See, Joint Committee on Taxation, Issues and Proposals Relating to the Financial Condition of the PBGC (JCS-3-93) (February 3, 1993) at 1 (herein, "Issues and Proposals").

address problem plans and sponsors, while preserving the flexibility that is the basis of the pension funding system. Although any measure to tighten funding rules can harm financially troubled plan sponsors, these approaches should be less onerous than some of the others discussed herein, and therefore less likely to push already weakened employers into insolvency.

POLICY ISSUES RELATING TO PENSION UNDERFUNDING

Any legislative response to pension underfunding must balance complex and conflicting interests. First, any changes should be made within the existing funding requirements which give employers considerable flexibility. These requirements, which have worked satisfactorily for most employers and plans, should not be completely changed. Furthermore, it would be unfair to abrogate the existing framework and subject employers who had entered into pension commitments to a different set of expectations.

Additionally, the majority of responsible plan sponsors should not bear the cost of strengthening the private defined benefit plan system and the PBGC. This would exalt the PBGC's "social insurance" aspect over its "casualty insurance" aspect. Forcing well-funded plans to subsidize further underfunded plans would also accelerate terminations of well-funded plans. James Lockhart, the PBGC's former Executive Director, stated at a Senate Finance Committee hearing in September, 1992 that the system is already losing 8000 fully funded pension plans per year.[2] Finally, while any changes in the current system must target problem employers and plans, these employers are often financially distressed. Therefore, new funding requirements should not be so harsh or drastic so as to push such employers into bankruptcy.

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[2] See, 19 BNA Pension Reporter (herein, "BPR") 1679 (Sept. 28, 1992).

PROPOSED CHANGES TO PENSION FUNDING REQUIREMENTS

Several approaches have been suggested in either proposed legislation or by commentators:

Proposals Relating to Plan Funding Requirements

1) Limiting benefit increases by an underfunded plan unless the plan's funding level is increased or additional security is provided.

2) Requiring that annual plan contributions equal or exceed the amount of benefit payments made during the prior year.

3) Eliminating or restricting the granting of minimum funding waivers, and giving the PBGC increased authority over them.

4) Requiring full funding on a current basis.

5) Reducing amortization periods for unfunded liabilities.

6) Phasing in a requirement that underfunded plans be brought current through increased contributions.

Proposals Relating to the PBGC

1) Improving the PBGC's premium enforcement and collection mechanisms.

2) Increasing PBGC termination insurance premiums.

3) Strengthening the PBGC's standing in bankruptcy.

ANALYSIS OF PROPOSALS

Proposals Relating to Funding Requirements

One alternative is to prohibit underfunded plans from increasing benefits unless funding is increased or security is posted in favor of the plan in the form of a surety bond, cash or U.S. government securities. This approach is narrowly tailored to address only problem plans, unlike the proposal to reduce amortization periods, which would affect all plans. Additionally, it is a variation of a security requirement in the current pension law.[3] Limiting benefit

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[3] See, Internal Revenue Code section 401(a)(29).

increases in the absence of adequate funding or security is particularly important in the area of collectively-bargained plans where contributions may not be based on actuarial estimates of the plans' accrued liability. Disadvantages of this approach are that it might adversely affect labor and management in certain industries whose ability to bargain collectively concerning pensions would be limited. Plan sponsors' ability to obtain credit for maintaining their business operations may also be negatively affected by a security requirement.[4]

A second alternative is to require the sponsor of an underfunded defined benefit plan to contribute annually at least as much as its plan paid out in benefits in the prior year. This is operationally perhaps the simplest proposal. However, it is somewhat inconsistent with the basic nature of single-employer defined benefit plans. Plan contributions are based on actuarial estimates of the amounts necessary to fund a promised future benefit stream, while current distributions are made to retirees and their beneficiaries on whose behalf the sponsor had made such contributions in the past. This method imposes a needed but somewhat rough financial control on plan sponsors that seek to increase benefits continually without funding them, and is supported (as part of a broader endorsement of HR 298) by several actuarial professional associations, including the American Academy of Actuaries, the American Society of Pension Actuaries, and the Society of Actuaries.[5] HR 3396 includes a plan solvency rule which links past plan disbursements and funding requirements. It generally requires employers to fund their plans to a level where there are enough assets available to pay at least three years' estimated benefits (based on the plan's expenditures during the prior twelve months.)

A third alternative is to eliminate minimum funding waivers. In general, the predicate for granting a minimum funding waiver is "temporary substantial business hardship" when the application of the minimum funding standard would be adverse to the interest of plan participants. The rationale for funding waivers assumes a reasonable chance that the employer will recover and meet the plan's costs in the future.

Some commentators have argued that minimum funding waivers have been granted too liberally and that many companies which receive them

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[4] Issues and Proposals at 23.

[5] See, BNA Pension and Benefits Daily (April 23, 1993) at 12-13.

never recover from their financial difficulties.[6] If their view is correct, the perceived problem may have been related to the administration of the waiver process rather than the basic concept. Minimum funding waivers should be retained in the pension law, but they should be even more difficult to obtain. Since the standard for receiving a funding waiver is a fact-oriented one rather than a "bright line" test, it is not as susceptible to tightening as a mechanical standard. However, Internal Revenue Code section 412(f)(3) (ERISA section 306) gives the IRS the right to extract security from a plan sponsor that has applied for a funding waiver. This right should be exercised more frequently. Additionally, a plan sponsor that received one waiver should not be granted another unless it can present particularly strong evidence of improvement or make a showing of the continued likelihood of its financial recovery. The PBGC's role in the waiver administration process should also be reviewed. The PBGC has a special stake in evaluating the quantitative risks inherent in funding waivers, because if the financial status of a plan sponsor that had received a waiver does not improve, the PBGC, rather than the IRS, will have to fund guaranteed benefits under Title IV of ERISA.

A fourth alternative would be to require all plans to be fully funded on a current basis. We believe that this approach would be an overbroad and extreme response to a serious but circumscribed problem which, as noted above, is concentrated in certain industries. It would deny funding flexibility to the vast majority of plan sponsors who have not abused such flexibility and would increase the relative unattractiveness of defined benefit plans, thus increasing terminations of well-funded plans.

A fifth alternative would be to accelerate amortization periods of unfunded liabilities. This approach is less of a departure from current law. Currently, sponsors of plans with unfunded liabilities can amortize the shortfall over varying periods of time, the longest being 40 years. Although shortening amortization periods would help the PBGC by accelerating funding, it could hurt the PBGC by driving other plan sponsors into bankruptcy. Since it would reduce funding flexibility, changing amortization periods could also encourage further terminations of well-funded plans.[7]

A sixth alternative would be increased phased-in contributions. This approach was included in the Bush Administration budget

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[6] _See_, 19 BPR 1481 (Aug. 17, 1992.)

[7] _Issues and Proposals_ at 24.

proposals in March, 1992 which called for contribution increases to large underfunded plans of approximately 30 percent, beginning in 1994. HR 3396 also includes measures requiring faster funding which will apply to recent benefits in plans that are less than 60 percent funded. Increased phased-in contributions also have some of the same shortcomings as the other major changes to the funding requirements discussed above.[8]

Proposals Relating to the PBGC

A General Accounting Office report states that the PBGC's current mechanisms for enforcing existing premium requirements are inadequate.[9] A House Ways and Means Oversight Subcommittee report released on November 7, 1991 discussed several basic steps to improve the PBGC's ability to collect premiums, such as developing the capability to determine the total number of plan sponsors required to pay premiums and to compute the premiums which are due, and annually to "match" data from PBGC's Form 1 (the annual PBGC premium payment form) to Form 5500 (the annual report for employee benefit plans.)[10]

Another approach is to raise premium rates. The PBGC single-employer plan insurance program charges two premiums, a flat rate premium (currently, $19 per participant), and a variable rate premium to which only underfunded plans are subjected (currently, a maximum of $53 per participant.) Increasing the flat rate premium is unsatisfactory. It has been repeatedly increased since ERISA's enactment, when it was $1 per participant. Even higher premiums may result in even more terminations of well-funded plans. Increasing variable rate premiums makes more sense, since it assigns the increased cost to the responsible plan sponsors. HR 3396 includes a phase-out of the cap on the variable rate premium over three years, with no increase in the flat-rate premium. However, employers paying the variable rate premium are often financially troubled, and increased premiums could divert funds needed for operations,

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[8] See page 6, supra.

[9] See, U.S. General Accounting Office, Pension Benefit Guaranty Corporation Needs to Improve Premium Collections ((GAO/HRD-92-103) June 30, 1992).

[10] See, 18 BPR 2045 (Nov. 11, 1991).

including plan funding, and could further weaken them, resulting in bankruptcy.[11]

Proposals have also been made to improve the PBGC's position in bankruptcy vis a vis other creditors. Former PBGC Executive Director James Lockhart stated at a Senate Finance Committee hearing that the bankruptcy courts had "gutted [PBGC's] legal position in bankruptcy."[12] One remedial proposal would (a) classify contributions attributable to pre-petition periods and employer liability for pre-petition plan terminations as pre-petition taxes with priority, and (b) treat post-petition contributions and employer liability for post-petition plan terminations as post-petition taxes with priority as administrative expenses. Permitting the PBGC to be a member of creditors' committees has also been suggested. HR 3396 includes two bankruptcy-related provisions. First, a contributing sponsor or controlled group member with an underfunded plan that liquidates in an insolvency proceeding will be jointly and severally liable for plan underfunding liability as if it had terminated such plan. Also, a bankrupt sponsor of an underfunded single employer plan will not be permitted to increase benefits during the bankruptcy proceeding.

Some of the changes discussed above would improve the PBGC's recovery rate in bankruptcy. Moreover, holding plan sponsors financially responsible for plan contributions before and during bankruptcy would reduce current incentives to terminate underfunded plans, and could cause creditors to pressure plan sponsors to keep plans adequately funded. However, strengthening the PBGC's position in bankruptcy could also result in reduced willingness of creditors

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[11] Issues and Proposals at 21.

[12] See, 19 BPR 1679 (Sept. 28, 1992).

to make loans, thus accelerating the failure of financially weakened plan sponsors.[13]

We appreciate having this opportunity to comment on the complex issue of pension underfunding and the PBGC, and encourage your efforts to resolve the problem. We have enclosed additional copies of this letter for the members of your committee.

Respectfully submitted,

COMMITTEE ON EMPLOYEE BENEFITS*

Jeanne Cullinan Ray
Chairman

cc: The Honorable Martin I. Slate

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[13] See, Employee Benefits Research Institute Brief No. 126, PBGC Solvency: Balancing Social and Casualty Insurance Perspectives (May, 1992).

*Members of the Committee on Employee Benefits

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WRITTEN COMMENTS ON BEHALF OF THE
MULTIEMPLOYER PENSION PLAN SOLVENCY COALITION
BY ROBERT M. SPIRA

FOR THE PRINTED RECORD OF THE HEARING ON OCTOBER 4, 1993, BY THE SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS & MEANS, U.S. HOUSE OF REPRESENTATIVES, ON THE ADMINISTRATION'S PROPOSALS TO REFORM THE FEDERAL GOVERNMENT'S INSURED PENSION BENEFIT PROGRAM.

Mr. Chairman and Members of the Subcommittee:

My name is Robert M. Spira. I am Director of Government Relations and Senior Corporate Counsel for Leaseway Transportation Corp. I am pleased to submit these written comments on behalf of the Multi-employer Pension Plan Solvency Coalition ("Coalition"). The Coalition is composed of employers who contribute to multiemployer pension plans, and of industry trade associations that represent employers who contribute to multiemployer pension plans. These associations include the American Trucking Associations, Inc., the Associated General Contractors of America, the National Constructors Association, the National Association of Waterfront Employers and the Food Marketing Institute. The Coalition's principal goal is the passage of legislation that will address the serious problems caused by underfunding in multiemployer pension plans.

On August 11, 1991, and again on August 1, 1992, representatives of the Coalition testified before this Subcommittee. The testimony established that serious problems exist as a result of recent increases in underfunding in multiemployer pension plans and as a result of the inability or unwillingness on the part of the Pension Benefit Guaranty Corporation ("PBGC") to monitor the financial health of multiemployer pension plans.

We were pleased that the Clinton Administration appointed an interagency task force to study problems at the PBGC and the government's pension insurance system in general. However, at the Subcommittee hearing on October 4, 1993 PBGC Executive Director Martin Slate testified that the PBGC had no plans to incorporate multiemployer plans into the Administration's pension reform proposal.

We think this decision is irresponsible.

Our position is supported by the following facts:

1. There are 9 million employees covered under 2000 multi-employer plans as of 1992. Approximately 3 million of these employees are covered by plans that are currently underfunded. Sixty multiemployer plans are funded at less than 50%.

2. From 1980 until 1990 multiemployer plan underfunding decreased from $33 billion to $5 billion but since then <u>underfunding has more than doubled</u>. Mr. Slate attributes this increase to the drop in interest rates and investment returns. However, a 1992 PBGC report states that both falling interest rates and <u>benefit increases</u> are the cause of this alarming rise in underfunding in these plans.

3. The impact of multiemployer plan underfunding has to be evaluated in light of the 40-60% declines in the number of active employees participating in many of the underfunded plans. These declines resulted from economic changes in the industries which sponsor multiemployer plans. The trends

support further declines in the number of employee participants.

4. In September, 1993, the General Accounting Office reported to Congress that the PBGC has not adequately assessed its liability for future financial assistance to financially-troubled multiemployer pension plans. If only one large multiemployer plan goes under, the surplus in the multiemployer insurance fund could be wiped out.

5. PBGC guarantees pension benefits well below the level retirees would expect to receive if they were to get all the benefits they were promised. Unfortunately, if a multiemployer pension plan becomes insolvent, the PBGC benefits are the only benefits those pensioners will receive regardless of the plan's promises. The maximum PBGC guarantee is calculated at $16.25 times the employee's years of service. A pensioner with 30 years of service would receive only $487.50 a month or $5850 a year as compared with the $2500 a month or $30,000 a year promised by some of the underfunded plans.

In summary, contributions with respect to fewer and fewer employees are expected to generate the funds to pay more retirees substantially higher benefits. If the assets available to pay the promised benefits prove to be inadequate, pensioners will receive substantially lower benefits than have been promised. Yet, the Task Force chooses to do nothing.

The Task Force is aware of the Coalition's concerns regarding the multiemployer pension plans. On June 11, the Coalition met with members of the Task Force to outline our concerns. The following is an excerpt from the written statement submitted to the Task Force at that meeting.

"Certain developments in the defined benefit pension plan system - both single-employer and multiemployer - are clear. Some of these plans are chronically underfunded. Aggregate plan underfunding has increased from $20 billion to $30 billion in 1990 to $51 billion in 1992. It will continue to increase. The situation will not improve under current law.

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According to the last three PBGC Annual Reports, the number of single-employer defined benefit pension plans has dropped sharply from 95,000 in 1990 to 85,000 in 1991 to 67,000 in 1992. This is a decrease of 30 percent in the past two years alone. The attrition is real.

The above information regarding defined benefit pension plans is relatively well known to those in the pension community. Our Coalition is concerned, however, that the larger and more visible problems in the PBGC's single-employer program will cause the weaknesses in multiemployer plans to be ignored. These weaknesses are masked by the surplus currently shown by PBGC in its multiemployer fund and by PBGC's assurances that the multiemployer program is healthy. However, one must look beyond the relatively small surplus and the PBGC's assurances and examine trends in the plans themselves in order to get the true and accurate picture.

Underfunding in multiemployer plans increased from $5 billion in 1990 to $11 billion in 1992. Therefore, over 20 percent of all current underfunding is attributed to multiemployer plans. According to PBGC estimates, the rate of increase in underfunding in multiemployer plans between 1990

and 1992 may actually be greater than the rate of increase in underfunding in single-employer plans over the same period of time.

In 1990, PBGC reported that 89 percent of all multiemployer plans covering about 80 percent of all multiemployer plan participants were fully funded for vested benefits. By 1992, however, only 80 percent of all multiemployer plans (covering about 68 percent of all multiemployer plan participants) were fully funded for vested benefits. Therefore, the number of underfunded multiemployer plans is increasing.

The single most serious threat to multiemployer plans is the decline in the number of active employee participants in these plans. [The following chart illustrates] the decline in the number of employees for whom contributions are being made in many of the most serious underfunded multiemployer plans. [(1)]

Multiemployer Fund	Initial Plan Yr/No. Active Employee Participants	Most Recent Plan Year/Number of Active Employee Participants	Reduction During Period
Central States SE & SW Areas Pension Fund	1979/427,319	1991/238,354	44%
NYSA-ILA Pension [(2)] Trust Fund & Plan Board of Trustees	1984/9,174	1991/4,470	51%
Teamsters Pension Trust of Philadelphia & Vicinity	1979/31,196	1991/14,170	55%
Chicago Truck Drivers, Helpers & Warehouse Workers Union	1980/6,281	1991/2,137	66%
Alaska Teamsters Employer Pension Trust	1983/9,056	1990/3,229	64%
Western Pennsylvania Teamsters Pension Fund	1979/19,664	1991/9,861	50%

[(1)] Statistics have been updated to include the most recent information available as of September 1, 1993.

[(2)] Recognizing the problem, the contribution base unit measurement of this fund subsequently was changed from a man-hour basis to a tonnage assessment fee.

Notwithstanding the increased level of underfunding and the decline in active employee participants that exists in multiemployer plans, fund trustees continue to increase benefits. According to the 1991 study of the funded position of the multiemployer plans published by the Segal Company, almost half of the underfunded plans included in the study implemented benefit improvements in 1991. These improvements are one of the principal reasons for the increase in underfunding that has occurred. Other multiemployer plans not included in the Segal study also implemented benefit improvements in 1991.

Given the combination of plan underfunding, declines in the number of active participants in these plans, and benefit increases -- where will the money come from to pay today's employees when they retire?

Many of the underfunded multiemployer pension plans are negatively impacted by the same problems that have led to underfunding in single-employer plans. They are in troubled sgements of the economy. They serve aging work forces. Some are in industries with declining union participation. In the trucking industry, the International Brotherhood of Teamsters has reported that 132 motor carriers (representing more than 170,000 union truck drivers) terminated operations since 1980. The surplus in the PBGC's multiemployer fund is not so large that it could survive the collapse of even one significant multiemployer plan.

We have been informed by PBGC that it monitors the financial condition of its multiemployer program. PBGC's "watch list" of troubled plans will only be effective to the extent that a troubled plan experiences an orderly, visible and gradual decline in its financial condition. However, current economic and competitive conditions create a climate in some industries in which business failures could trigger uncollectible withdrawal liability claims at a pace far quicker than could be monitored effectively by the PBGC.

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Although the Task Force is focusing its attention on weaknesses in pension plans as they relate to the PBGC insurance program, the Task Force should not lose sight of the impact of underfunding on the employers contributing to multiemployer plans. Under the Multiemployer Pension Plan Admendments Act of 1980 ("MPPAA"), employers are liable for their pro rata share of unfunded vested benefit liabilities ("withdrawal liability"). These liabilities can be substantial. For example, one member of our Coalition has contingent liabilities to multiemployer plans that are over 40% of 1992 revenues.

Given the funding status of some of these plans, the contingent liability can have a critical impact on several aspects of the business of the contributing employer. It depreciates the value of the business in the market place. It negatively impacts applicable credit ratings and interest rates. If a claim against a contributing employer arises because of a complete or partial withdrawal from a plan, the claim could easily bankrupt a struggling company.

Leaseway Transportation's situation is illustrative of the problem. Leaseway Transportation is a trucking company with diverse operations throughout the United States. Revenue in 1992 exceeded $700 million. Leaseway Transportation currently contributes to 38 multiemployer plans. We employ drivers for the purpose of providing trucking services to shippers under specific transportation agreements. If a shipper cancels its contract with us, we lose the business and must terminate the employees dedicated to that shipper. This reduces our contribution base with the applicable pension fund. Depending on the circumstances, the customer cancellation may lead to a complete or partial withdrawal from the pension fund. If so, the fund will assess withdrawal liability against Leaseway because of actions taken by a customer and not by Leaseway. Leaseway's withdrawal liability to all the multiemployer plans to which it contributes is estimated to be approximately $80 million. Although we do not desire to withdraw from any of the plans in which we participate, events outside of our control could result in claims that exceed our ability to pay.

Supporters for the present system have often claimed that multiemployer pension plan underfunding should be controlled through the collective bargaining process. This suggestion loses sight of what is and is not settled through collective bargaining. Wages and fringe benefit costs, including contributions to the pension fund, are negotiated through collective bargaining.

The needed financial controls are not available to contributing employers through management of the funds. Although multiemployer funds have boards of trustees appointed in equal numbers by the unions and by management, most contributing employers, particularly in the trucking industry, have no voice in the identity of the employer representatives or in their decision making. Even if the employer representatives of a fund chose to stand together to block unfunded pension benefit improvements, binding arbitration provisions of the fund could take the decision out of their hands. Because of the fiduciary obligation which trustees owe to manage the fund solely for the benefit of the employees and their beneficiares, it would be extremely difficult for a trustee to stand firm against benefit improvements proposed by other trustees.

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If the Task Force is concerned solely with the status of the PBGC's fund, it will not meet the objective of assuring that participating employees and retirees will receive the benefits they have been promised. PBGC guaranteed benefits are not the same as the benefits promised by the plan. In some cases, they can be substantially less.

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Many solutions have been proposed to deal with the exposures to the PBGC's insurance fund. Across the board premium increases penalize fully funded plans by requiring them to incur additional expense as a result of the funding problems of other pension plans. Faster funding requirements, without a limitation on benefit increases, would not necessarily reduce pension plan underfunding.

We believe that strict adherence to two principles will resolve the problem. First, the focus should be on the underfunded plans. Second, the solution must ultimately encourage all pension plans to become fully funded. In addition to reducing the risk of claims against the PBGC's insurance program, full funding is the only way to assure that participating employees and retirees will receive the benefits they have been promised.

We are not alone in our opionion. The Oversight Subcommittee of the House Ways and Means Committee has held a series of hearings regarding the PBGC's problems. The Subcommittee has recently issued a report which includes findings and recommendations resulting from the hearings. The Subcommittee's findings, which are applicable to single-employer and to multiemployer defined benefit pension plans, include the following:

1. PBGC's financial solvency and the defined benefit pension system are at risk.

2. Underfunding is increasing as a result of new unfunded pension promises.

In response to the above, the Subcommittee recommended that, as a short term solution, immediate action be taken to reduce the increases in underfunding that occur in single-employer and in multiemployer plans when underfunded plans grant new pension plan promises.

The short term legislative solution recommended by the Subcommittee is reflected in Title II of the Pension funding Improvements Act of 1993 (H.R. 298/S. 105) sponsored principally by Congressman J.J. Pickle and Senator James M. Jeffords. Title II will limit unsecured benefit increases in single-employer and in multiemployer plans. A plan with a ratio of plan assets to plan liabilities of less than 90 percent would be required to provide security to the plan before it could increase benefits.

Although Title II does not guarantee that underfunding will be eliminated, it does assure that increases in underfunding will not be attributable to future benefit increases. Title II places the burden exactly where it belongs: on the underfunded plans.

We recognize that managers of some multiemployer plans have expressed opposition to Title II because, in their opinion: (1) it is not necessary and (2) it is intended to undermine the multiemployer pension system. The trends in certain multiemployer plans which we described above -- increases in the level of underfunding, declines in the number of active employee participants, and increases in benefits -- demonstrate that changes are needed if underfunding is to be reduced.

The reductions in underfunding that should result from the legislation would not undermine the multiemployer pension system as some have feared. It is not the goal of the members of our Coalition to avoid withdrawal liability. Rather, it is our goal to eliminate such liability to the extent a fund is reasonably able to do so. A reduction in underfunding would not motivate contributing employers to withdraw from a multiemployer fund, but would eliminate one of the principle reasons why employers avoid commitments that require them to join a multiemployer fund. The legislation would result in a healthier pension system for employers and employees.

At a minimum, Title II will "stop the bleeding" while other solutions to the ills of the defined benefit pension system are studied. The short term solution reflected in Title II has been recommended by the Congressional Budget Office and the General Accounting Office in their Oversight Subcommittee testimony.

Title II would not establish a new legislative framework for multiemployer plans, but would create a balance among the contributions required to be paid by employers, benefit levels established by trustees and the financial condition of the plan. It would, in effect, provide the needed controls against the irresponsible benefit increase decisions of some fund trustees. By controlling underfunding, it would also encourage new employers to join these plans."

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Since our meeting with the Task Force, there have been several significant events that have focused attention on the need for legislative reform.

In June, St. Johnsbury Trucking, one of the largest carriers in New England, filed for bankruptcy and shut its doors. This will result in a substantial decline (approximately 10%) in the number of active employee participants in the New England Fund.

In July, the Coalition became aware of a benefit increase granted in 1991 by the trustees of the New England Fund. This increase, which patterns in many ways the 1991 increase granted by the Central States Fund, increases the maximum benefit from $1,000 per month to $2,500 per month. The effect of the increase is that the deficit of the New England Fund on which withdrawal liability is computed increased 79%, from $239 million in 1991 to $429 million in 1992.

The following is an updated list which describes the most recent information available to the Coalition regarding the funded status of certain multiemployer plans: [3]

Multiemployer Fund	Recent Plan Year/ Unfunded Vested Bought Liability of the Plan
Central States SE & SW Areas Pension Fund	1991/$2,274,642,000
NYSA-ILA Pension Trust Fund & Plan Board of Trustees	1991/$321,767,100[4]
Teamsters Pension Trust of Philadelphia & Vicinity	1991/$228,828,938
Chicago Truck Drivers, Helpers & Warehouse Workers Union	1992/$86,458,300[4]
Alaska Teamsters Employer Pension Trust	1990/$76,138,346
Western Pennsylvania Teamsters Pension Fund	1990/$38,350,535

The closing of St. Johnsbury, the recent benefit improvements adopted by the New England Fund and continuing high levels of underfunding in a substantial number of muliemployer plans, when taken together, demonstrate the "death spiral" which affects critical portions of the PBGC's multiemployer program. Contributions with respect to fewer and fewer employees are expected to generate the funds to pay more retirees substantially higher benefits. This is the "voodoo economics" of the '90's. These trends were demonstrated to the Task Force, yet, they chose to do nothing. If the Clinton Administration does not address the problem now, it will be leaving a much larger problem to be dealt with later.

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[3] The Coalition has continued to research the funded status of multiemployer pension plans. In addition to the trends in the financial conditions of the funds, as described above, our study also demonstrated that certain trends which we described in our 1991 testimony to this subcommittee regarding the availability of information regarding multiemployer plans are continuing. Form 5500's are not available. When they are available, they are not complete or up to date. Thorough and comprehensive research is impossible. As indicated on Page 12 of The General Accounting Office's ("GAO") September, 1993 Report to the Congress, the GAO has had similar problems funding information regarding the underfunded multiemployer plans.

[4] As a result of deficiencies on the filings of the NYSA-ILA Fund and of the Chicago Truck Drivers Fund, the list sets forth current liability for total benefits for those funds as of the Plan Year indicated.

The Congress should adopt changes to the defined benefit pension plan system that will reduce the underfunding. We understand and are sympathetic to the hardships to some retirees that will result from restrictions on benefit increases. However, the limited restrictions on benefit increases that we propose are less harmful to retirees than proposals that tie the coverage offered by the PBGC's insurance program to plan funding levels and less harmful to the defined benefit pension system that large across the board premium increases. Any solution proposed should focus on the need to assure employees that they will receive the benefits that they have been promised.

There is really no acceptable reason why pension reform legislation should not address underfunding in multiemployer pension plans. It is irresponsible to ignore the trend toward unchecked underfunding in these plans caused, in part, by unfunded benefit increases. Title II of HR 298 would go a long way toward guaranteeing that workers in single-employer and in multiemployer pension plans receive the benefits they were promised. Please make sure Title II is a part of any pension reform legislation recommended to the Ways and Means Committee.

STATEMENT OF THE PRINCIPAL FINANCIAL GROUP

STATEMENT REGARDING PROPOSALS TO STRENGTHEN THE PENSION BENEFIT GUARANTY CORPORATION (PBGC)

THE ISSUE

The PBGC single-employer fund currently has a large funding shortfall. Despite increases in PBGC premium rates and legislation intended to limit PBGC's liability, the PBGC's financial condition continues to worsen. The Administration's task force examined the problem and recently released its recommendation — referred to as The Retirement Protection Act of 1993 — on changes needed to strengthen the PBGC. The recommendation aims to improve the defined benefit plan system and protect the benefits of plan participants.

BACKGROUND

Congress established the PBGC in 1974 under ERISA to insure, to a large degree, payments made under most defined benefit pension plans. Congress established two programs—the multi-employer program (which currently operates at a surplus) and the single-employer program (which currently operates at a loss). Both programs were to be entirely funded by the premiums paid by plans PBGC insures. The minimum annual premium has increased from $1 in 1974 to the current $19 per participant, with a possible additional premium of $53 per participant for underfunded plans ($72 maximum premium).

PBGC's Current Status

- The PBGC's deficit for the single-employer fund was $2.7 billion in 1992.
- The PBGC is predicted to assume future liabilities of $30-45 billion as a result of plan terminations in the next 15-20 years, due to minimal funding of a minority of defined benefit plans and increased benefits due to plan terminations or plant shut downs.
- Potential liability rests primarily with certain industries or specific plan types.
  - $40 billion underfunding is concentrated in the steel, airline and automobile industries ($13 billion of this in financially troubled companies).
  - Troubled plans are typically larger ones with "dollars times years of service" benefit formulas (e.g. a monthly benefit of $10 for each year of service with the employer).
- PBGC has sufficient revenues and assets on hand to meet its obligation for many years.

THE PRINCIPAL POSITION

The Principal believes a strong PBGC is essential to the national pension system. It must remain a safety net to insure the benefits of defined benefit plan participants. We applaud the portions of the Administration's proposal which help protect the retirement security of millions of workers and retirees. We agree that while the PBGC is not in immediate danger, changes should be made now — while the problem is still manageable. For that reason, we believe the Administration's proposal is a step in the right direction. However, we are concerned about some provisions which seem to be unrelated to strengthening the PBGC. We offer the following additional comments and concerns:

1. **Proposals We Strongly Support**
   - Strengthen funding rules for underfunded pension plans to require faster funding;
   - Prohibit employers from increasing benefits in underfunded plans during bankruptcy proceedings;
   - Phase out the current cap on PBGC's variable rate premium over three years;
   - Eliminate quarterly premium contributions for fully funded plans;
   - Eliminate the 10% excise tax on certain nondeductible contributions;
   - Enable PBGC to seek judicial relief short of plan termination when corporate transactions threaten pension funding (e.g., seeking a court order to require a departing controlled group member to remain responsible for pension underfunding for a specific period of time or to post security for part of the pension liabilities);
   - Enable plans to file claims against a liquidating sponsor or controlled group member without plan termination;
   - Enable PBGC to enforce minimum funding requirements; and
   - Improve PBGC's current authority to file liens for missed contributions.

In particular, The Principal supports the goal of strengthening the PBGC's financial condition through tougher funding requirements for underfunded plans. We feel the Administration's proposal will, in general, achieve this goal. We are particularly pleased that the proposed funding rule changes will not affect fully funded plans.

The Principal also supports prohibiting employers from increasing benefits in underfunded plans during bankruptcy proceedings. We believe that the proposal should also prohibit certain plan amendments which do not directly increase a plan's benefit formula, but do substantially increase a participant's benefit. These would include plant shut down benefits, changes to a plan's early retirement provisions, or lump sum benefit options. Each of these provisions could increase a participant's retirement benefit and thus increase the potential liability of the PBGC.

The Principal also supports the proposal to increase premiums for those plans most at risk. Phasing out the cap on the variable rate premium will encourage underfunded plan sponsors to improve their funding levels. We strongly support the recommendation to retain (or lower) the flat premium rate of $19. Plan sponsors of fully funded plans cannot—and should not be asked to—bear repeated premium increases. Each time the base rate premium has increased, more sponsors of fully funded plans have terminated their plans, resulting in less pension coverage nationwide and further pressure on the PBGC. Requiring plan sponsors of underfunded plans to take more responsibility for their underfunding is highly appropriate.

2. Proposals Requiring Clarification

- Include transition rules to ease the impact of the new funding rules;
- Establish new reporting requirements to provide information on seriously underfunded plans to PBGC;
- Protect the interests of participants who cannot be located upon plan termination by requiring the plan sponsor to transfer sufficient assets to pay the participants' benefits to the PBGC;
- Round dollar limits for Cost of Living Adjustments;
- Specify uniform assumptions for calculating a plan's minimum funding contribution; and
- Specify assumptions to be used to calculate participants' lump sum benefit payments.

The Principal questions whether the new funding rules should be phased in over a transition period. This sort of transition rule is a great example of why maintaining a pension plan is so complicated. We believe it is appropriate to consider applying the funding rules in 1995 (without a transition period) and then let plan sponsors apply for a waiver to the IRS of a portion of the funding requirement under the waiver rules as currently in effect.

We support the idea of additional PBGC reporting requirements but believe there will likely be noncompliance with the new rules. Employers, particularly those owned by foreign companies, may not know all the members of the controlled group and may not know if a reportable event has occurred. Also, one service provider may not provide plan services (actuarial valuation, recordkeeping, etc.) to the entire controlled group. Therefore, the service provider will not be able to monitor the plans and determine if a reportable event has occurred. This will likely result in unintentional noncompliance by some plans.

The Principal believes the proposals regarding single sum distributions and rounding cost of living adjustments are separate issues. Neither proposal addresses the issue of improving plan funding. We are particularly concerned about the single sum distribution proposal since it impacts all defined benefit plans and requires plan amendments. Before we can support this item we need more information about using the 30 Year Treasury Rate — Is it averaged over time? Can the rate on the first day of the plan year be used? As for the proposal to round the cost of living adjustments, we question whether a provision designed to hold down the tax expenditure for qualified plans should be included in a PBGC funding proposal.

3. Proposals We Cannot Support

- Add a plan solvency rule requiring underfunded plans to have enough liquid assets to pay at least 3 years of benefits;
- Broaden disclosure of information for participants and retirees on their plan's underfunding and the limits of PBGC's guarantee through an annual plain-language explanation of their plan's funding status; and
- Eliminate cross-testing of defined contribution plans on benefits basis.

We have several reservations about the proposal to require a plan to hold cash equal to three years' worth of payments (based on the last 12 months). First, a solvency rule based on payments for the prior 12 months will not ensure adequate assets to pay future benefits. Instead, any solvency rule should be based on the plan's expected benefit payments. Second, we question whether Congress should dictate to plan sponsors how to invest plan assets. We believe the DOL can ensure that plan sponsors and trustees have sufficient assets on hand to pay benefits through enforcement of ERISA's fiduciary prudent person rule. If some modification is really needed, we suggest guidelines requiring plan sponsors to take into account expected benefit payments when establishing asset allocations.

The Principal supports the goal of educating participants about their retirement benefits and preparing them to make better financial decisions. We believe each plan sponsor should provide participants with information about their plan benefits and explanations of the PBGC's guarantee of those benefits. However, we question whether increasing the disclosure requirements to participants about the plan's funding status will improve the level of plan funding. Since participants generally have no say about a plan's funding level, it is hard to see that this will do much to solve the core problem of plan underfunding.

We support the concept of cross testing defined contributions on a benefit basis and feel it is an important plan design option. It has opened up some new plan design options and is bringing more employers (and members) into the private pension system. While some plan sponsors may use this to skew benefits in favor of the highly paid employees, the majority use it to provide non-discriminatory benefits to all their employees. If change is needed, we would favor modification of the current rules rather than outright elimination.

SUMMARY

The Principal believes a strong PBGC is essential to the national pension system and must remain a safety net to insure the benefits of plan participants. In general, we support the Administration's efforts to better coordinate the methods of determining minimum funding requirements and actual plan termination liability in order to reduce the amount of underfunding at plan termination. We also support efforts to place more responsibility on employers and employees for establishing affordable benefits. However, we do have reservations about several of the proposed changes and hope that Congress will consider carefully whether the changes will indeed achieve the goal of improving the financial status of the PBGC.

Information About The Principal Financial Group

The Principal Financial Group is a family of insurance and financial services with assets of more than $41 billion. Its largest member company, Principal Mutual Life Insurance Company, is currently the fourth largest life insurance company in the nation ranked by premium income.

The Principal Financial Group serves 703,000 individual policy holders, more than 74,000 group employer clients, 25,700 pension contractholders and 62,600 mutual fund shareholder accounts. In all, 7.6 million customers (businesses, individuals, and their dependents) rely on the companies of The Principal Financial Group for their financial services needs.

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October 29, 1993

DELIVERED BY HAND

The Honorable J.J. Pickle
Chairman, Ways & Means Subcommittee on Oversight
United States House of Representatives
1135 Longworth House Office Building
Washington, D.C. 20515

Re: Statement for the Record,
October 4, 1993 Hearings on
PBGC's Pension Funding Proposals

Dear Mr. Chairman:

This is a statement for the record relating to your subcommittee's hearings on October 4 on the PBGC's proposals for strengthening the funding requirements for defined-benefit pension plans. The Profit Sharing Council of America has no comments on the basic funding proposals since the Council primarily speaks for its members and their employees on defined contribution plan issues. However, Martin Slate, Executive Director of the Pension Benefit Guaranty Corporation, in his written statement included several recommended changes, not directly related to funding, among which was the "elimination of so-called 'age-weighted' profit-sharing plans". It is this recommendation which this statement for the record is addressed.

The Profit Sharing Council of America (PSCA), a long established organization, is a national non-profit association of 1,200 companies and their 2 millions employees. PSCA members are diverse businesses bound by a common belief: that sharing profits with employees--the people who make profits possible--has a wide range of benefits to the American economy.

The Profit Sharing Council of America strongly favors retaining companies' ability to use age-weighted and service-weighted formulas to allocate company contributions in defined-contribution plans. These broad-based plans, some of which have existed for decades, have been authorized consistently under regulations and administrative determinations, including the Internal Revenue Code Section 401(a)(4) non-discrimination regulations issued on August 30, 1993.

Every business operates under a unique set of circumstances and, therefore, must have access to retirement-plan design options than can be adapted to suit these diverse needs. Defined-contribution plans have grown steadily in popularity over the last two decades because they give plan sponsors maximum design flexibility. Restricting or eliminating the use of age-weighted or service-weighted profit-sharing plans erodes plan sponsors' ability to take full advantage of this flexibility. For some employers, this can mean the difference between sponsoring a retirement-plan and not sponsoring one at all.

Under age-weighted and service-weighted profit-sharing plans, sponsors provide employer-funded benefits to employees based on company profitability. For a younger worker, a contribution made to an age-weighted or service-weighted profit-sharing plan compounds for many years and translates into a retirement benefit that is proportional to the benefit provided to an older worker who has accumulated funds in the plan over a shorter period. Service-weighted plans also allow companies to reward employees for their long service and loyalty to the company and encourage employees to stay with the company. Defined-benefit and target-benefit plans already allow employers

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to fund benefits for older workers over a shorter period of time and to reward long-service employees. Age-weighted and service-weighted plans achieve the same goal, but also allow employers to adjust contribution levels as business conditions or profitability change.

Plan sponsors find it increasingly difficult to fund adequate retirement programs due to the increasingly burdensome administrative and regulatory complexities imposed by Congress and the Internal Revenue Service (IRS) since the passage of the Employee Retirement Income Security Act of 1974 (ERISA). Age-weighted and service-weighted plans offer an attractive option to many plan sponsors that otherwise might not be able to offer a retirement-plan to their employees.

However, PSCA is aware of public policymakers' concerns that these allocation methods might be used to unfairly benefit highly compensated employees. If such practices occur, PSCA offers its assistance in developing alternatives to current regulatory approaches.

Companies should be permitted to continue to sponsor age-weighted and service-weighted profit-sharing plans.

- **If age-weighted and service-weighted plans are eliminated, many plan participants will see their benefits reduced.** According to PSCA's *36th Annual Survey of Profit Sharing and 401(k) Plans,* 11.7 percent of the 811 respondents offer age-weighted or service-weighted plans. Therefore, if age-weighted and service-weighted plans are eliminated, more than 221,000 participants and $26.7 billion in plan assets would be affected--just among PSCA's survey respondents.

- **Small businesses need weighted plans.** Small businesses don't turn a profit overnight. It takes years of nurturing and development to reach the stage where the company is profitable enough to sponsor a retirement-plan. By that point, the company's employees are older and have been with the company for a number of years, and the company needs to have the ability to sponsor a plan that allows accelerated funding. A defined-benefit plan would meet this need; however, small businesses typically cannot afford to sponsor defined-benefit plans because of their funding requirements and expensive administrative overhead.

- **Age-weighted and service-weighted plans must comply with the Section 401(a)(4) regulations.** The final Internal Revenue Code Section 401(a)(4) regulations provide that a plan can discriminate in favor of highly compensated employees (HCEs) with respect to contributions, as long as plan benefits are non-discriminatory, and that a plan can discriminate in favor of HCEs with respect to benefits, as long as contributions are non-discriminatory. However, a plan cannot discriminate in both respects. Age-weighted and service-weighted plans must comply with the Section 401(a)(4) regulations.

- **Other regulatory limits also affect age-weighted and service-weighted plans.** As with all defined-contribution plans, age-weighted and service-weighted plan contributions are limited by several regulations in addition to Section 401(a)(4). For example, total annual contributions cannot exceed 25 percent of an individual's compensation, up to a maximum of $30,000, and total company contributions to a profit-sharing plan cannot exceed 15 percent of payroll. These limitations serve to curb the potential for companies to disproportionately provide retirement benefits through these plans to HCEs. The $30,000 limit is substantially less than the contribution that would be required under a defined-benefit plan for an older HCE, and the

$30,000 limit has become even more restrictive each year since it was enacted because it has not been indexed for inflation.

For employees of small companies, additional regulations protect against plan benefits being disproportionately allocated to HCEs. Under the top-heavy rules, if 60 percent of a plan's assets are held in HCEs' accounts, as a group, the plan sponsor must make at least a 3 percent contribution to the account of every eligible lower-compensated employee, and that contribution must be 100 percent vested.

- **Comparability-plan design offers even greater flexibility.** Comparability plans allow plan sponsors to provide different contribution levels to different groups of employees. For example, a plan could be designed so that one employee group is comprised of all mid-level managers over the age of 50, while another group would be comprised of mid-level managers who are under that age. Alternatively, employees of different classifications or divisions could be designated to different groups. These groups can be designed to satisfy various employer objectives--such as benefiting older employees, providing larger contributions to longer-service employees, providing management incentives or rewarding employees who satisfy predetermined production or incentive goals--while still falling within the allowable non-discrimination guidelines.

- **Age-weighted and service-weighted plan participants are protected against loss of benefits.** By definition, defined-contribution plans are completely funded on a current basis because the plan sponsor contributes directly to the employee's individual account. Therefore, statements that age-weighted and service-weighted plans offer none of the protections of a defined-benefit plan is inaccurate. Defined-contribution plan participants, unlike defined-benefit plan participants, have to assume any investment risk. However, the rules relating to a plan sponsor's fiduciary responsibilities with respect to investments are very stringent. In addition, defined-contribution plan participants may enjoy the benefit of receiving higher-than-expected yields on their investments, an advantage that defined-benefit participants do not share.

Conclusion

Since 1974, continual changes to the rules under which qualified retirement-plans operate have been a major deterrent to employers that wish to adopt or maintain these plans. As a consequence, the percentage of employees covered under qualified retirement-plans has decreased during the last decade. The private retirement-plan community has waited a full seven years for final regulations providing guidance in the important area of non-discrimination. But only one month after the final regulations were issued, the administration proposes to eliminate a key method for complying with the non-discrimination rules. These changes make planning and compliance, and therefore providing meaningful retirement benefits to employees, extremely expensive and unnecessarily complex.

Respectfully submitted,

David L. Wray

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President
Profit Sharing Council of America

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